

# PRIVATIZATION

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Privatization, Serial No. 104-6, 10...

## HEARINGS

BEFORE THE

### COMMITTEE ON THE BUDGET

### HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

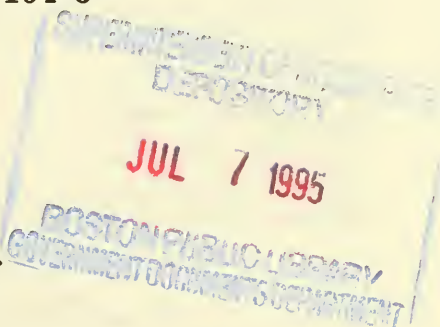
FIRST SESSION

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HEARINGS HELD IN WASHINGTON, DC, FEBRUARY 28 AND  
MARCH 1, 1995

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**Serial No. 104-6**



Printed for the use of the Committee on the Budget

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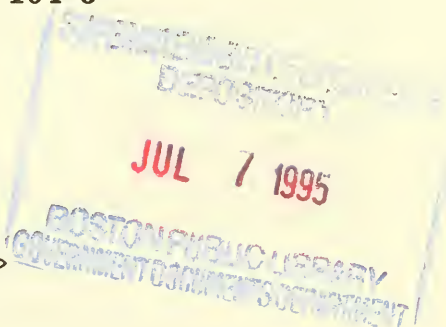
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# PRIVATIZATION

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TUESDAY, FEBRUARY 28, 1995

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON THE BUDGET,  
*Washington, DC.*

The committee met, pursuant to call, at 10:07 a.m., in room 210, Cannon House Office Building, Hon. John R. Kasich (chairman of the committee) presiding.

Members present: Representatives Kasich, Shays, Allard, Smith of Michigan, Hoke, Molinari, Hoekstra, Largent, Myrick, Brownback, Radanovich, Bass, Sabo, Stenholm, Slaughter, Johnston, Pomeroy, Browder, Woolsey, Roybal-Allard, and Meek.

Chairman KASICH. The committee will come to order.

This morning we are going to hear from Scott Klug, who is heading up a privatization task force for the House Republicans. Scott, we appreciate you being here this morning. The floor is yours.

## STATEMENT OF HON. SCOTT KLUG, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. KLUG. Thanks, Mr. Chairman. I apologize, I am late, I just came from a press conference with some of my freshmen colleagues on privatizing functions in the House, so I apologize, but we wanted to make some time to do that for sure.

It has been interesting that ever since the mid-1950's, in the Eisenhower administration, it has really been the stated principle of the Federal Government that we would privatize as many services as possible and to essentially get out of the business of competing with private firms on what private firms can do best. Even though that has officially been the mantra over several administrations, from a practical perspective, there has been very little privatization done in the Federal Government, with the exception of perhaps Comsat and Conrail in the 1980's.

A number of the ideas we are going to talk about today have actually been floating around since the late 1970's or early 1980's. So it is not necessarily a function of us not having the ideas, it has always been a problem getting them accomplished.

If we look, I think as we have, over the last several weeks in our debate about what we should shift to the state, if you think of a large flow chart, it seems to me we have largely ignored the right side of that equation, that we have spent a lot of time saying should government do this? And if government should do it, should the State government or the local government do it.



Mr. Chairman, what I think we have really ignored is the second half of the equation, which is, should the government do it? And if the answer is "no," how do we then get out of the business?

If you look all across this country, many States have been more innovative on issues like welfare reform. A number of State and local governments across the country have been way in front of the curve on us, in terms of privatization, and that includes everything from privatizing janitorial services in State capitols to using private firms for garbage collections.

I want to talk about four specific issues, if I could, for about 15 minutes to lay out some of the groundwork, and I think we need to define three kinds of privatization issues. The first are asset sales or leases which I think, in many ways, are the easiest and the cleanest for us to do. The second is the general idea of contracting out services. And the third is the idea of functional conversion. Then finally let me spend just a few minutes talking with the committee about some of the barriers now in law or now in executive order which make it very difficult to, in fact, accomplish privatization.

I was asked by the Speaker some months ago, and I want to thank the chairman for his nudging the Speaker to get us rolling on this project, to take a look at privatization ideas. If you want to go back to a set of ideas that I think have been clearly defined and very well thought out, again in the early 1980's, it was the idea of selling a number of projects connected with the U.S. Army Corps of Engineers, the Department of Interior, Bureau of Reclamation, or the Department of Energy itself.

First and foremost, and I think really the easiest no-brainer in all of this is the Naval Petroleum Reserves which were established in the Roosevelt administration, as in Teddy not Franklin, to guarantee the U.S. Navy would have an adequate supply of petroleum when they were converting from coal and wood to an oil-fired fleet. We have actually held these reserves since the turn of the century. Many of them are located in southern California where there are several oilfields. There is also an oilfield in Wyoming, famous in an earlier Republican administration, called Teapot Dome. It turns out in the oil shale reserves that we began holding in the 1970's, there is a significant natural gas discovery in California itself.

Shearson-Lehman was asked by the Federal Government in the mid-1980's to do a large analysis of whether or not we should hold those reserves and essentially use them as a stream of revenue or whether we should sell them off. Shearson-Lehman's conclusion, much as most calculations you see on hold-sell strategies, determine that the Federal Government could essentially make 20 percent more money by selling them immediately than it could by using them as a stream of revenue.

There is one very simple explanation for that, if I asked everyone on this committee if they would like \$50,000 a year over the next 10 years, or if you would like \$500,000 today, there is a time value of money. And secondly, the government operations, which have been literally, in some cases in southern California, located next to private operations, have been wildly more expensive.

For example, of the 80 percent of the Elk Hill petroleum reserve now run by the Federal Government, Bechtel has an average of 70



workers per 100 wells. Chevron, which has fields literally right next door, has an average of 12 workers per 100 wells. So we can A, get more money up front; and B, run the services much more productively.

The second asset that I think falls into the same category, which is one we have all talked about and laughed about for years, is the National Helium Reserve located in San Antonio, TX. I cannot think of one that gets bigger laughs in audiences when I am out there trying to understand why the Federal Government today wants to hold on to helium reserves established in the 1920's so we would have adequate supplies of helium for dirigible research.

Now over the years, any one of these government projects, as you know, has a tendency to morph over time to essentially take on a new definition and a new service. But I think anybody who looks at the National Helium Reserve, and my colleague, Chris Cox from California, has been way out in front of this, has suggested that it is time to get the Federal Government completely out of the business. As we are going to see in a number of these initiatives, we get some money up front but even more importantly we wipe debt off the books that is presently owing to the Federal Government, in terms of taxpayer's subsidized loans.

The third suggestion—that is out there that is well on the way, in fact we had hearings in Commerce last week to complete the final steps—is the United States Enrichment Corporation. For years, the United States took all the uranium in the United States, processed it, used some of it for weapons research, and then sold the rest to nuclear reactors. We ran the United States Enrichment Corporation so inefficiently that at one time we had 100 percent of the world's market and today we have 40 percent. That is why we decided to privatize and we took the initial step to make it a government-owned corporation. We will, by law, have to report by July of this year how we will take the final step for privatizing itself.

Finally, in the energy resource area, I was delighted that when the President's budget came out earlier this year, that the President has endorsed the idea of privatizing four of the Power Marketing Administrations. Now if it was my choice, we would also add Bonneville and Tennessee to that list. But at a minimum, it seems to me, we should begin to privatize the four Power Marketing Administrations, which are Alaska, Southeastern, Southwestern, and Western. If we did them, we would take appropriations off the books, for example \$6.5 million, \$22 million, \$21 million, and \$266 million for each of those.

But even more importantly and fundamentally, and I think this goes back to my earlier statement, if today we decide in the 1990's there are some things the government should not be doing, it seems to me owning and operating 132 dams has got to be really high on the list. Nearly a third of the Department of Energy's employees run the dams and sell off power.

In an area where we are moving to retail wheeling in the utility business, which essentially means somebody in Michigan today, Mr. Chairman, will soon be able to sell power in Ohio, and Ohio into Pennsylvania. Why should the Federal Government have exclusive marketing territories?

Here is an interesting kicker. The last time this was seriously discussed, in 1986, there was legislation stuck into an appropriations bill which made it illegal for the Department of Energy to discuss, explore, or produce any kinds of reports on selling off or privatizing the Power Marketing Administration. So today it is illegal for anybody in the Department of Energy to explore these options, which must have made for some very interesting discussions between OMB and the Department of Energy on trying to price these out in the President's budget.

But we think, based on some estimations we have seen, that Alaska is worth about \$85 million; Southeastern, \$909 million; the combined price tag of Southwestern and the Western Power Administration, we estimate to be about \$3.5 billion. So if you took the four of those together, you could get close to \$4 billion.

Now how we accomplish this, I think, is an interesting argument. You could lease them back or you could literally sell them off, depending upon whatever the best strategy is. But until we lift the gag rule on the Department of Energy, it is going to be very difficult to get an honest assessment of what the price tag should be.

Let me move to the next section of ideas generally. This is, rather than selling off assets, move toward privatization and contracting out to make government services more efficient. Again, most economists will tell you, and most experts in this field will tell you, any time you move from the government supplying services to the private sector supplying the services, there is a net savings of about 20 percent.

In the 1970's, the Carter administration had, as one of its highest priorities, substantially increasing the number of IRS collection agents in order to guarantee we would collect a lot of bad debt that is out in the private sector, owed but not collected by the Internal Revenue Service. The IRS is currently owed in excess of \$150 billion in outstanding tax debt. That figure is 80 percent higher than the \$87 billion that was estimated in 1990.

Now there are three States, New Jersey, Maine, and Alabama, which have all been leaders in increasingly moving to private collection firms to collect IRS debt. For example, the State of New Jersey's experience has been, in collecting back taxes in their States, that for every dollar the State pays it collects roughly \$4 in unpaid bills. And if that is the model we could use here and private collectors, for example, say that their success rate tends to be about 18 percent, that rate applied to the \$56 billion the IRS wrote off as uncollectible in 1994 could mean \$10 billion in finances immediately.

Again, there is no way to tell or to guarantee what the Federal Government could take in, but given the rather dismal experience of the IRS and given the dismal success they have had in collecting bad debts over the years, it seems to me at a minimum we should look at setting up sections of the country where we try private collection firms to see if this pays off.

Now as I told you, I was late for a couple of minutes because I just finished a press conference with the freshmen who have been very aggressive in pushing for in-house privatization and there are two areas in particular here which are of interest to me.

First of all, the Government Printing Office. If we are going to set a marker for the rest of the country, and if we are really going to talk seriously about, at some point, privatizing the Tennessee Valley Authority, then it seems to me it is absolutely unconscionable to have the Congress of the United States continue to run a printing office that essentially costs twice as much in printing a document of what it does in the private sector. Every time we print something for a buck, we could print it for 50 cents if we simply let it out in the service.

And again, in this day and age, when anybody understands anything about the printing industry and the great kinds of changes you have seen in desktop publishing, it makes no sense at all for the Federal Government to continue to own and to continue to invest. We spent \$25 million last year in buying new printing equipment for the Government Printing Office. GPO has 4,000 employees today. If you shrunk that to about 800 you could turn it simply into a procurement agency, close down inefficient plants, be able to shrink the GPO work force from 4,000 employees to about 800 employees and save money and get the same job done.

Now I have had some colleagues say wait a minute, can we really trust the private sector to do things like publish the Congressional Record? If the Wall Street Journal manages to get edited every evening and then distributed by satellite and it shows up on my doorstep in Madison, WI, the next morning at 5 o'clock, I think one of the 100,000 private printing companies in the United States could somehow figure out how to get something transcribed over in the U.S. Capitol and move it from a block to the Cannon Office Building.

Also again, I think, significant in terms of symbolism are a number of functions still done in the U.S. Capitol that should be privatized. A number of the freshmen, including Mr. Brownback who is with us today, introduced legislation that will drop barriers to allow the House Administration Committee to privatize a number of functions within the House itself. I think House Information Services, janitorial services, all the kind of maintenance work you see around here are perfect examples. And when you see, for example, Venetian blind operators in the U.S. Capitol making close to \$50,000 a year and when the House Barbershop loses money, rather than makes money, every year, I think you have to ask yourself why we are still in the business of doing that.

I suspect if we would say here is an office, you can run a dry cleaning shop out of it and pay rent, here is an office you can run a Venetian blind operation out of here. Here is an office, run a supply store out of here. We could actually take all of those businesses from losing money into making money for the U.S. taxpayers.

The final section I want to talk about, and you will see in the statement in front of you some ideas I will not dwell on, but that is the idea of functional conversions. That is the central theme we took in the 1980's when we privatized Conrail or when we privatized Comsat, which was the Communications Satellite. The administration, for example, in their current budget has indicated that the National Weather Service, for example, should stop providing specialized forecasting such as fruit and agricultural forecasting.



Anybody in this room, Mr. Nussle for example, who has a lot of farmers in Iowa, the pork producers, the corn growers, the cranberry growers in Wisconsin, Mr. Brownback's wheat growers in Kansas, all use private forecasting firms. These are redundant services that, in this day and age, we really do not need to do. Anybody who listens to the radio stations today and hears AccuWeather or Weather Central or any of the other private services understands that the National Weather Service can really shrink dramatically to its core function of tracking potentially dangerous storms and hurricanes and tornadoes and we can leave a lot of those kinds of businesses to the private sector itself.

The U.S. Post Office and Amtrak, of course, have been explored by some of my colleagues. Mr. Hefley, in particular, and the chairman, Mr. Kasich, has been outspoken in terms of the ability to do the FAA.

Let me talk about one other area that I think is vitally important, and that is a wide range of services now under GSE's. Like my earlier references to a couple of the other projects we talked about, the GSE's may not necessarily get the government any money in the short run, but what it does is wipe a huge potential liability off the books, which I think is very important, as we look at consolidating and eliminating debt.

Perhaps the foremost candidate for, in my mind, to take on this function right now is Sallie Mae, as the Federal Government essentially gets out of the loan business, as we have with the administration's initiative on direct loans, which I parenthetically think was a mistake. But if we are going to move out of that business, then the question has to be why does the Federal Government still have any ties to Sallie Mae whatsoever, and we should move as quickly as possible to privatize Sallie Mae and to allow them to assume the debt so that the Federal Government does not have to worry about it. And once we take a look at Sallie Mae, it seems to me that Fannie Mae and Freddie Mac are not far around the corner.

Mr. Chairman, the final thing I would like to submit to the committee for the record are a series of barriers to privatization which you will actually see as the pages 19 through 22 in the document in front of you. We asked the Congressional Research Service if they would go back and find a number of the barriers which will prevent us from doing this.

If you will look, there are a wide range from the gag rule I told you earlier about, involving the Power Marketing Administrations, which is on the Department of Energy, to the Government Printing Office. For example, there is a ban that says no appropriated funds are allowed to be used by the executive branch for the procurement from commercial sources of any printing-related production of government publications. There is really no reason for me to go down and read each of these individually, but I think it is clear for anyone who cares to read through these that while we may all agree philosophically we want to do this, and while we may want to guarantee that some of these are included in the budget document you are going to put together in the next 6 months, there are some very realistic legal barriers that have to be removed or will have to be struck in order that we can move forward.

Many of my colleagues may have seen a report that was done last week by the Heritage Foundation on how to achieve \$11 billion in savings. On the back of that, you will see some other barriers to privatization that are listed. I caution those of you who look at this document that many of these are out of date, and actually are barriers to privatization that may have existed when some of these ideas were first put together in the early 1980's. Since then many of them have been eliminated and stricken already.

So the list that you have on the back of the testimony I presented to you, I think, is a much more realistic description of the barriers that are in front of us today.

[The information of Mr. Klug follows:]

PREPARED STATEMENT OF HON. SCOTT KLUG, A REPRESENTATIVE IN CONGRESS FROM  
THE STATE OF WISCONSIN

#### PRIVATIZATION

Privatization can range from contracting out relatively simple services such as building maintenance or food services to transferring enormous government functions and assets such as postal operations or railroads to private ownership. The thread of similarity that runs through all privatization is increased value to the taxpayers. Overall, the experiences of local, state, and federal governments around the world indicate that the private sector, driven by profits and regulated by market forces, perform more effectively, more efficiently, and at a lower cost than do governments.

We have many examples from around the world to draw from in exploring privatization options. Countries like Canada, Argentina, France, Australia, and Russia have all taken steps to privatize government functions—particularly in the energy industry.

Privatization is not only an option for the Federal Government to balance the budget, but also, an opportunity for the Federal Government to help competition in the free market. In the current fiscal challenges facing the U.S. Government, the budget is a powerful tool capable of encouraging, sometimes forcing, behaviors and actions that will ensure sound financial health as we move into the next century. The committee should also note that according to various studies done on privatization, governments could save as much as 20 percent of their current costs of operation by simply eliminating the overhead costs from the budget. I hope that privatization will receive the full consideration of this committee as a commonsense budgetary option.

The various options under privatization can be broken down into four categories:

- Asset Sales or Leases;
- Contracting Out;
- Functional Conversion; and
- Lifting Barriers to Privatization.

#### PRIVATIZATION: ASSETS SALES OR LEASES

Since my appointment as "Privatization Point-Man" by the Speaker, my office has been approached by a number of people from the private sector who have an interest in investing in Federal Government assets ranging from the hydroelectric facilities under the U.S. Army Corps of Engineers and the Department of Interior Bureau of Reclamation to the Naval Petroleum Reserves under the Department of Energy. I wanted to brief the committee on a few options to sell government assets.

#### NAVAL PETROLEUM RESERVES [NPR]

Selling Naval Petroleum Reserves would bring in a projected net revenue of \$1.6 billion. The combined savings from selling the NPR would be \$1–2 billion. President Clinton included the proposed sale of NPR in his 1996 budget request.

NPR was established back in the early 1900's under the Navy to provide oil for navy ships. In 1977, it was transferred to the Department of Energy. NPR's annual cash flow is \$300 million for Elk Hills alone. Currently, the site is managed by the government personnel but the oil production is operated by Bechtel under a contract to the government.

## NATIONAL HELIUM RESERVES

Since it was established in 1925, the National Helium Reserves has accumulated a debt of \$1.4 billion. Selling the processing and storage facilities of the National Helium Reserves alone would save the Federal Government \$16 million by 2000. The National Helium Reserves nearly monopolizes the market by controlling 90 percent of the Nation's helium reserves. It is time for this program to operate more efficiently and more cost effectively under the free market of the private sector.

## UNITED STATES ENRICHMENT CORPORATION [USEC]

The House Energy and Power Commerce Committee held hearings on privatizing the USEC last week. The USEC is entering its final stages of privatization and it required to submit a privatization plan to Congress by July 1, 1995, to sell by fiscal year 1998. The Energy Policy Act of 1992 established the Uranium Enrichment Corporation as a Federal corporation for eventual privatization. The proposed selling price is at least \$1.5 billion.

## POWER MARKETING ADMINISTRATION [PMA]

Selling the PMA's would save taxpayers approximately \$280 million of appropriations every year. The five administrations include the:

Alaska Power Administration (fiscal year 1995 = \$6.5 million). APA proposed selling price = \$85 million;

Southeastern Power Administration (fiscal year 1995 = \$22.5 million). SEPA proposed selling price = \$909 million;

Southwestern Power Administration (fiscal year 1995 = \$21.3 million). SWPA and WAPA proposed selling price = \$3.5 billion;

Western Area Power Administration (fiscal year 1995 = \$266 million); and

Bonneville Power Administration (Debt = \$3.7 billion). BPA proposed selling price = \$7 billion.

I recommend privatizing the PMA's in the above order from least to most complex and learn from each as we go along. The revenues from selling the assets of the PMA's could bring in an estimated \$11.5 billion. The President's proposed privatizing all of the PMA's except for the Bonneville Power Administration in his fiscal year 1996 budget proposal by transferring the rights to market the power.

The U.S. electric industry is becoming more competitive, that is, the interconnection of local utilities, the growing significance of independent suppliers, and the use of wholesale power markets. The industry's competitive structure has the potential to reduce the cost of power and increase service reliability. Government subsidized power prevents the American public from enjoying the benefits of increased competition.

## TENNESSEE VALLEY AUTHORITY [TVA]

While the power programs under TVA does not receive a direct appropriation from Congress, their nonpower program costs Congress approximately \$140 million a year. These nonpower programs include recreational programs, the promotion of public use of the land and water resources and the operation of a national fertilizer and environmental research center—all at taxpayers' expense. TVA also boasts of having \$22 billion worth of assets, making it the largest utility in the Nation. Privatizing TVA would not only save taxpayers \$140 million annually, it would relieve the government of the \$28 billion debt TVA owes to both the Federal Government and the private sector.

## COMMODITY PRODUCING LAND

Existing policies and Federal control over commodity (timber, grazing, et cetera) producing lands discourage provision of wildlife habitat and land preservation. In addition to evidence that government ownership does not guarantee environmental protection, the commodity production efforts of government agencies lose money every year. Between 1977 and 1988 losses on timber, grazing, and mineral programs totaled \$31 billion.

Other activities such as hunting, camping, and fishing are heavily subsidized. This subsidization results in unrealistically low government prices that serve to retard private incentive to develop recreational lands.

A privatization plan that takes into account environmental, commodity and recreational interests offers a way to eliminate taxpayer subsidies to special interests, increase the value and utility of American lands and provide tens of billions in sales revenues.



# PRIVATIZATION: CONTRACTING OUT

IRS Debt Collection: The IRS currently is owed in excess of \$150 billion in outstanding tax debt. This figure is 80 percent higher than the \$87 billion that was owed in 1990. One cause of this tremendous increase is that annual collections of delinquent taxes have dropped from \$25 billion in 1990 to \$23 billion in 1994.

In its 1995 High Risk Series Report, GAO stated "IRS has also not taken full advantage of the vast experience that private sector collection companies have in areas such as locating debtors and managing accounts receivable. Testing the use of such companies \* \* \* may be an appropriate step in reengineering IRS' tax collection processes."

A 1994 GAO report indicates that States using private collection companies to collect delinquent individual income taxes, generally viewed the collection agencies as effective in their collections. An American Collectors Association Survey shows that private collectors average an 18 percent success rate on all debts. That rate applied to the \$56 billion that the IRS deemed uncollectible in 1994 would result in savings to the taxpayers of over \$10 billion.

In-House Privatization: Here in the House of Representatives, we have many services available to us that can be easily contracted out. It makes no sense to have House beauticians or House barbers on the Federal payroll when these services can be provided by the private sector. Also on the Federal payroll, taxpayers pay as much as \$50,000 for Venetian blind cleaners and technicians and carpet layers and carpet cleaners. Other House services to consider for contracting out include the House Office Supply, some of the functions under the Office of Photography, Office Furnishings and various maintenance functions for the House office buildings. Privatizing these functions would save as much as \$44 million a year in salaries and appropriations alone. This does not even include the revenues brought in from renting or leasing. There is no reason for our constituents to continue paying for these services.

## GOVERNMENT PRINTING OFFICE

The Government Printing Office, created in 1860, handles the printing needs of all three branches of the Federal Government. All printing must be sent to the GPO, where it is either printed or contracted out by bid to private printers. The GPO contracts out about 80 percent of the printing.

Congressional printing (the Congressional Record, Federal Register, bills, resolutions, committee reports, et cetera) makes up most of what the GPO prints in house. The in-house printing costs are estimated to be twice those of privately printed materials.

By transferring executive branch printing to GSA, transferring some other functions to the Librarian of Congress, and reducing in-house printing to a minimum level, the GPO work force could be reduced from approximately 4,100 to approximately 800, saving an estimated \$80 million per year.

## PRISONS

Federal prisons are operating at as much as 51 percent above capacity. Limited capital budgets, and other fiscal constraints, make it difficult to take action to reduce overcrowding by using taxes or bonds to finance construction of new facilities.

Experience at some Federal agencies and the local government level shows that private prison companies can construct or manage prisons for as much as 20 percent less than government-built and operated facilities. The U.S. Marshall Service contracts with private firms to run some minimum security facilities. Some two-thirds of detention centers at all levels of government are privately run. The Federal Bureau of Prisons has not kept pace.

The government needs to require Bureau of Prisons to conduct studies and where feasible, contract out some prison facilities. Also there is a need for legislation, such as tax consideration and lifting of Federal land-use restrictions, to help local governments in their efforts to further privatize. The President's fiscal year 1996 budget includes intentions to privatize the management of most future pretrial and minimum and low security facilities now under construction.

## CONTRACTING (GENERAL)

When the Federal Government competes with companies in the private sector, it stifles private industry growth and erodes the tax base by doing work that would otherwise be performed by taxpaying firms. This especially puts small businesses at a disadvantage. Having the Department of Defense and the Veteran's Adminis-



tration involved in operating their own grocery distribution systems is but one example of the areas in which government competes with the private sector.

The General Accounting Office [GAO] and the Office of Management and Budget [OMB] estimate that competitive contracting saves an average of \$9,000 per year for each government position that it replaces. Using this figure, the Heritage Foundation recently estimated that the government could save as much as \$9 billion a year by contracting out the approximately 1 million government positions currently involved in the provision of "commercial" services.

#### PRIVATIZATION: FUNCTIONAL CONVERSIONS

**National Weather Service:** The National Weather Service [NWS] in 1990 issued a policy which in part stated, "The NWS will not compete with the private sector when a service is currently provided by commercial enterprises, unless otherwise directed by applicable law." Nevertheless, NWS continues to provide specialized functions such as fruit and agricultural forecasting, domestic aviation and marine weather forecasting, fire weather forecasting, marine facsimile service, and regional climate centers. These functions together cost the taxpayers over \$12 million per year.

Private firms are quite capable of providing all of these services and the users are quite capable of paying. American taxpayers should not be asked to subsidize the narrow interests of a few. NWS should spend its resources focusing on its core missions of collecting and disseminating worldwide weather data and information and providing severe weather warnings and weather forecasts to the general public.

**Federal Loan Programs:** In attempting to service and manage a \$155 billion loan portfolio and \$450 billion in loan guarantees, the Federal Government engages in commercial activities usually performed by private banks and investment firms. Federal agencies administering loans have inadequate collection efforts, poorly managed loan programs, and improper accounting procedures.

Agencies should sell loans to private markets without recourse and should purchase private reinsurance for loan guarantees. Selling the loans would provide for more accurate and proper budget treatment allowing agencies' funding to be better managed. Moreover, the government would be relieved of the servicing costs and would benefit from more efficient private servicing of the loans, which, according to recent studies, could result in savings of \$2 billion per year.

**United States Postal Service [USPS]:** The operations of the USPS have not kept up with customer expectations. Mail delivery is 15 percent slower now than it was 25 years ago. Post Office hours are inconvenient, worker productivity is declining, and improper measurements and management emphasis on the wrong things has caused truckloads of undelivered mail.

Telephones, facsimile machines, cable, satellites, computers, television, and radio are all methods used by people to communicate around the world. The USPS is being abandoned by people at an alarming rate and is now just another nonessential service provided by the Federal Government.

To bring about lower prices and better service, the government should begin to empower postal workers with the rights and responsibilities of ownership by turning the USPS into an employee-owned company.

**Government Sponsored Enterprises:** This one is a little more complex. The principal issues are governance, accountability, and liability, not necessarily direct budgetary reductions. Government Sponsored Enterprises [GSE] are instrumentalities of the Federal Government. They are privately owned and operated, but are exempt from most, but not all laws and regulations applicable to Federal agencies and to similar private enterprises.

The Reagan administration favored eliminating GSE's arguing that federally supported borrowing distorted the allocation of financial resources and discouraged borrowers without access to Federal subsidies. Others contend that GSE's are a legitimate means of encouraging the flow of credit to favored groups—such as farmers, home buyers, students, and thrift institutions—considered not capable of competing with other borrowers. The Student Loan Marketing Association [Sallie Mae], a GSE set up to help ensure adequate private sector funding for federally guaranteed education loans is currently seeking full privatization which will remove a \$50-billion contingent liability from the taxpayers. Sallie Mae wants to expand into new markets and is prohibited from doing so by their government charter which also gives them such advantages as access to Federal funds, exemption from State and local taxes, and exemption from certain SEC requirements.

In any event, the implicit Federal backing of the GSE's exposes the taxpayers to contingent liabilities approaching \$700 billion and the GSE's access to low-cost Federal borrowing stifles competition in the marketplace.

NASA's Aeronautical Research and Development: For fiscal year 1995, \$882 million has been appropriated for Aeronautical Research and Technology [AR&T]. Much of this money is for research on such things as future supersonic civil air transport capabilities and developing environmentally compatible, economical aircraft, all commercial applications.

NASA has been criticized for being inefficient and unresponsive to industry needs for R&D. Currently, U.S. firms spend 25 percent of development testing time in European wind tunnels where capability and cost-effectiveness are considered greater. European facilities, built with government funding, are privately operated. Arguably, the inefficiency of government run R&D has retarded development in private aviation by discouraging more efficient businesses from entering the market.

Private industry began studying investment research facilities. Industry's self-funded approach, however, was abandoned when the Clinton administration showed a proclivity to provide government-supported research to bolster U.S. competitiveness in the world aviation market and ensure adequate defense support. Moving this effort to the private sector could save more than \$800 million per year.

Amtrak: The National Rail Passenger Corporation [Amtrak] was created in 1970 with a one-time grant of \$40 million. It was conceived as a 2-year program that would become self sufficient. However, it has cost the taxpayers over \$15 billion since its creation.

Amtrak carries less than 1 percent of all intercity travelers but is still the most highly subsidized form of intercity transportation. It could need as much as \$10 billion over the next 5 years to maintain its current level of service and its need for Federal assistance will continue to increase because of legislative interference and burdensome regulation.

Federal subsidies need to be phased out, inappropriate labor regulations need changing and government interference with operating management should be eliminated. This effort could save taxpayers as much as \$2 billion per year.

Air Traffic Control: With approximately 46,000 employees, the FAA regulates air transportation and operates various support services. Air traffic control is the largest FAA function, employing more than 26,000 people. The air traffic control system is composed of flight service stations, airport traffic control towers and enroute air traffic control centers. The flight service stations provide weather briefings and other information to aviators, while the control towers and centers provide traffic control.

A more extensive involvement of the private sector in the management of the delivery and maintenance of air traffic services would improve their effectiveness, safety, and cost. The FAA already has contracted out some control towers and has found this to be effective. The role for the private sector needs to be increased to bring more creativity and ingenuity to the maintenance of these facilities. The President's fiscal year 1996 budget calls for privatization of air traffic control and recent studies show that it could save up to \$18 billion between 1996 and 2005.

#### PRIVATIZATION: BARRIERS

Many of the obstacles Congress faces in privatization initiatives are not only from those who oppose privatizing various government entities. Many of these obstacles were placed by the Federal Government. Lifting these barriers is a key first step to carrying out and, in some cases, simply looking into the possibilities for privatization.

##### Department of Agriculture:

The Farmers Home Administration, Agricultural Stabilization and Conservation Service, and the Soil Conservation Service are required to keep minimum employment levels; and

The Farmers Home Administration is prohibited from contracting out with private debt collection firms to collect delinquent payments.

##### Department of Defense:

Army depots have a minimum civilian employment level requirement; and

The Department of Defense is prohibited from contracting out security and firefighting services.

##### Department of Energy:

The Department of Energy is prohibited from studying the sale the Power Marketing Administration, except Alaska. (The prohibition applies to the Tennessee Valley Authority [TVA] which is under the Department of Energy.)

##### Government Printing Office:

No appropriated funds are allowed to be used by the executive branch for the procurement from commercial sources of any printing related production of government publications.

Department of Housing and Urban Development:

The Public and Indian House Program has minimum employment levels.

Department of Labor:

The Job Corps is prohibited to contract out any Civilian Conservation Center.

Department of Transportation:

The FAA is prohibited from contracting out functions of an airport control tower at any airport; and

The Department of Transportation is prohibited from funding changes in the current Federal status of the Transportation Systems Center or the Turner-Fairbank Highway Research Center.

Department of Treasury:

No appropriated funds are allowed to be used for the study of the possibility of contracting out or the actual contracting out of positions under the U.S. Mint Police Force and the Bureau of Engraving and Printing Police Force. Currently, Congress is required to be notified before the Department of Labor and/or the Department of Treasury contract out or privatize any functions under their jurisdiction;

No Federal funds shall go to contracting out or privatizing any functions or activities presently performed by Federal employees in the Department of Labor unless the Appropriation Committees of both Houses of Congress are notified 15 days in advance; and

No appropriations shall be used for contracting out or privatizing any functions activities presently performed by Federal employees in the Department of Treasury unless the Appropriations Committees on both Houses are notified 15 days in advance of such reprogramming of funds.

Chairman KASICH. Thank you, Mr. Klug. There is an awful lot of very interesting things in here.

Let me ask you, first of all, about the BPA, Bonneville Power Administration. That is the mother of all power marketing operations; is that right?

Mr. KLUG. I agree.

Chairman KASICH. Or is that bigger than TVA?

Mr. KLUG. I think TVA is a little bit bigger. Bonneville is a little more complicated in that you have some issues with Indian treaty rights and some issues involving salmon runs that make it a little more complicated to separate out. But I think as you move toward retail wheeling, probably the most valuable resource that any of the Power Marketing Administrations has is the power grid that BPA owns and operates, and I think that, literally itself, is worth billions of dollars.

Chairman KASICH. I notice that the TVA was excluded from the Balanced Budget Amendment over in the Senate. Somehow somebody slipped something in over there that keeps it off the table.

Why don't you run through with us, BPA, if we sold it, is estimated to save about \$7 billion. Why don't you spend just a little bit of time talking about how it works, how we would sell it, where the opposition comes from, and—we had a discussion among Republicans about whether we are going to sell the power marketing from the Grand Coulee Dam but keep the power marketing in the Northwest. Tell us a little bit about how it works and how it could be privatized, what the impact would be?

Mr. KLUG. If you work your way up the feed chain, Alaska is the simplest of all of these. Alaska, I think, is virtually a done deal. In fact, it should have been accomplished last year but got caught in the Senate at the end of the day when nothing was moving through the Senate.

As you work your way up again through the food chain, Southeastern, Southwestern, and Western are a little more complicated. BPA is the most difficult. The opposition, quite frankly, tends to



come from people from either Washington or Oregon, since it is the service area of BPA.

The argument with many of the Power Marketing Administrations is that if you take them apart and sell them off, what you A, may see happen, is rates rise in the service areas which would be unfair to people in the Pacific Northwest or the Tennessee Valley. Or B, if you take them apart, what you may find at the end of the day is that somebody is left holding a series of nuclear power plants that are not particularly efficient or competitive. That is the major concern with both TVA and the Bonneville Power Administration.

My sense would be that if you take the Power Marketing Administrations and sell them apart, it is true that in some areas that power rates may rise. But if what we are trying to look at is a national perspective, when you even it out, I think for the people of the United States generally it is a winner, simply from the power price perspective.

Secondly, it is true that Bonneville and TVA may have some assets that are not particularly marketable, but frankly so do a number of private utilities in the United States. And at a time, for example, when Commonwealth Edison, which has a lot of nuclear plants, is going to have to compete with Wisconsin Power and Electric, which does not, that is the real world that the private utility industry and the publicly-owned utility industry is going to have to deal with. It seems to me that we are going to, at some point, have to remove those barriers that now prevent us from looking at competition in either Bonneville's region or the TVA's region.

So I am convinced you can take them apart and there are a number of ways to do it. For example, if you look at the British model, what they did was to allow people in the service areas for utilities that were privatized to be able to buy stock at a premium. So if you bought two shares, if you were somebody who actually was a customer of the British utilities that went private, you got a third share.

You could also see us, in some cases, selling off the dams. You could, in some cases, I think, see us leasing back the dams with agreements to maintain them at the same point. And frankly, for the municipal utilities or the rural electric co-ops who are worried about the implication of this, they frankly would also have the ability to compete and either lease back some of the dams or buy the dams outright.

So I, frankly, do not understand, given the age of electric deregulation we are about to enter, how the Federal Government in any way can justify Federal dollars still being used to maintain and operate dams and sell off the electricity from them.

Chairman KASICH. Let me ask you about the Weather Service. Man, talk about stirring up a hornet's nest. What you say here is that there are some functions that we should continue to have the Weather Service to do. I consider the Weather Service to be sort of like the Census, where the Census is out doing a lot of marketing for companies and companies do not pay. If you have ever been asked to complete a Census, they want to know everything in the world and it becomes a marketing tool, which I am opposed to. I think there ought to be a user fee.

Is that essentially what you are saying about the Weather Service?

Mr. KLUG. I think the Weather Service's most valuable assets are clearly the weather satellites themselves. Assuming we are going to hold on to the weather satellites themselves, I think the question gets to be then who interprets the data produced by the weather satellite?

When we privatized Comsat and some of the communications satellites, I think we made a mistake because what we did was guarantee that so many people had access to the information you essentially dramatically undercut the value of the information itself. And the same thing with the Weather Service. If you are going to make some money off the data that comes from the Weather Service satellites, if you make it available to everybody in the world, pretty soon nobody is really going to be willing to pay very much for it.

I think, as we have talked to people in the private forecasting industry, they would still like to see the National Weather Service maintain some of its forecasting services for emergencies; hurricane watches, tornado warnings in the Midwest, examples of violent storms hitting Hawaii. But I think you have to ask if they really need to do much above and beyond that.

I think it is much like the Agricultural Research Service offices. I think a number of those Weather Service offices across the country can be closed down and eliminated. I think the mechanism is out there, the question is the mechanism to actually accomplish it.

My sense is we should err on the side of aggression and being very aggressive in closing down National Weather Service Functions. If you look at what some of the recommendations the National Weather Service itself made, versus what the Clinton administration embraced, the Clinton administration I think erred on the side of caution and I would encourage you to look at even more of the options the National Weather Service itself has discussed.

Chairman KASICH. The final question I have, in the area of the IRS. You argue every Presidential candidate for the last 20 years has said that he could balance the budget if we would just collect all this delinquent debt out there. Now I got involved in debt collection back in 1983. The GAO came in and told me that the idea that there is all this debt out there that we could get our hands on just if we went and were more aggressive is false. You have these IRS agents that go out and they are experts in hot-wiring cars and driving them away from people who owe money, but what they will tell you is that it is essentially trying to squeeze blood out of a turnip.

I do not know whether that is true. You now have a 1995 report that I noticed somewhere in here that indicates, or at least implies, that they feel that if you moved aggressively in this area you could save big chunks of money. Is that the way you understand it? Let us be honest here about this whole IRS business.

Mr. KLUG. I think in the past, some of the estimates on what you could collect were wildly overestimated. But I also think the IRS has underperformed. When you see the debts climb from \$87 billion to \$150 billion, and the delinquent taxes drop—the annual collections of delinquent taxes actually drop from \$25 billion to \$23 billion, something is going on in that spread.

Now maybe the IRS would argue that is a more realistic projection of bad loans they are actually writing off, they could never collect. But again, I think if we are looking to State governments for models, and again the experience has been in New Jersey that when they went to private collection firms, they were able to collect about \$4 for every dollar they had to pay off. Because you remember, collection firms only collect and only make money when they actually collect bad loans.

It seems to me, Mr. Chairman, it is an idea worth exploring. I do not care if we go nationwide or maybe we try to do this IRS region by IRS region to see what the experience is. But clearly the idea, back in 1976, that we would hire many more IRS collection agents and it would result in dramatic revenue increases simply were not true. Before I am willing to assume those are bad loans that can never be collected, or bad debts that can never be collected, I would like to see us turn to private collection firms to see whether they can deliver or not.

And if they cannot, I do not think we have lost anything, since the only way they make money is if they collect money.

Chairman KASICH. Good point. I am going to have to inquire with the GAO, their sense of what is outstanding and can these private operations work better. I think we ought to try to get to the bottom of it. Mr. Sabo.

Mr. SABO. Thank you, Mr. Klug, lots of interesting ideas.

I am curious, did you look at mining laws? It has always seemed one of the craziest things we have are the old mining laws, both in terms of the leases we get, and in comparison to the private sector.

Mr. KLUG. I did not in the sense that we did not look at any private ways to collect mining royalties, since there are not any mining royalties collected at this point, period. So it is not a question of who collects, it is just whether we get them, period.

Mr. SABO. It is a question of what kind of leases we get to start with it.

Mr. KLUG. I agree with the thrust of your question. I think that is a tremendous source of revenue we have overlooked. I voted, in the past, for mining law reform, to require royalties, and actually am working with Congressman Rahall this time out, to try to take the lead on some of the mining reform laws themselves.

If you look, for example, at the green scissors project, which was an interesting series of budget issues put together by the National Taxpayer's Union and Friends of the Earth and a number of other taxpayer groups, including the Concord Coalition, Citizens Against Government Waste, the Sierra Club, and a number of environmental groups, high on their list was mining reform.

We can argue about what the precise figures should be, but it seems to be absolutely unconscionable that we do not collect royalties commensurate with the value of the money mining companies make on those lands.

So I agree with you, we should do that immediately.

Mr. SABO. Let me ask a question that relates to contracting out, which I guess is different than privatizing in some cases. And the reality is for the bulk of government expenditures we do contract out. The part of the Federal budget that is exploding the most is



what we fundamentally contract out by asking the private sector to provide health care services; namely Medicare. In health care, we do not provide the service, rather we contract with somebody else to do it. And that is the heart of our budget problem understanding how to control that service that we are contracting for.

But for lots of the day-to-day operations of government, it has always struck me that there are times when it makes sense to contract out. Other times, though, we are driven by two different motivations to get around salary constraints. One is, at times, to get around the top pay restrictions for the Federal Government. So we contract out to someone or set up entities apart from the Federal Government, so we can get around the Federal pay cap for certain people. And the other is, at the other end of the spectrum, we contract out because we can contract out to people who do not pay decently, do not provide health care, and do not provide pension benefits.

I really have trouble when that is our motivation. I just think what is happening to the erosion of the basic wage structure for basic service employees in this country is one of the most fundamental social and economic problems we face. The erosion of health benefits for workers and the erosion of pension benefits for workers are major social problems in my area. So I just think that it is essential that if we are going to contract out, motivation simply cannot be that we are going to do another system where the Federal Government is simply making sure that there are lots of people working who are not getting a livable wage, are not getting health benefits, and are not getting pension benefits. That just seems to be a motivating factor in so many cases.

It seems to me to make the case for contracting out it has to be one that also assumes that we are going to treat people who we contract with decently. I am not sure how we deal with the other question of the top of the wage base.

In the defense bill last year we limited salaries that could be used for reimbursement by the Federal Government to \$250,000, as I recall. But our history, as we have dealt with Federal pay over the years, is we could not compete, not only with the private sector, but we could not compete with the nonprofit sector around the country. I am not sure what the right answer is there, but on the other end, I am absolutely convinced it has got to prove itself affordable or a wise decision, even if somebody is paying decent salaries with decent benefits to people.

I am also curious about something else. I looked at helium over the last couple of years to see why do we not do helium? And every time it would save us some money in the short run and cost us some money in the long run. Many of the amendments that we have had that have been promoted as saving money have actually cost us money.

Mr. KLUG. My understanding of the helium reserves is that it may have some short-term costs but again, as it wipes out a substantial Federal debt that is on the books, and given the fact there are now private competitors to the helium reserve, that we should just be out of the business, period.

Mr. SABO. I think, though, in the long run, every number I saw at least, you could sell it or you could do something with it. In the



end, it ended up costing us money rather than savings us money. It might wipe some debt off the book but we buy some every year and my understanding is every year, at least when I looked at it, the numbers I got was it cost us money and did not save us money.

Mr. KLUG. Let me argue two points philosophically. First of all, any resource that we hold, that unless you can convince me there is a compelling reason from a national security perspective to hold it, like oil, which I do not think we should have any business in today, or helium, I think the government simply should get out of it. If the private sector is providing it at a reasonable service and there is no national security reason to hold it, and we have had some ties in the past, for example on the United States Enrichment Corporation because of the applications of weapons grade uranium, then there is a reason for us to be involved.

On the point you were making earlier, in terms of salaries and benefits in the public sector versus the private sector, my sense is my first obligation are to taxpayers in Wisconsin and the taxpayers in the United States. And while it may be a difficult decision, it seems to me our first mission should be to make the budget balance, not necessarily to see ourselves as an employment agency.

Mr. SABO. I am not talking about being an employment agency, but I am talking about treating people who work for us fairly and for people that we contract, making sure that our goal is simply not to have workers working without health or pension benefits.

Mr. KLUG. If you look at municipalities, a number of municipalities for years had workers who literally did sanitary services, who picked up garbage. And you see increasingly most municipalities looking to private collection firms because they can save money and hold down taxpayers' bills because of it. I think that is a small illustration of what we can do at the Federal Government level.

The States and the local governments have been very aggressive in these kinds of ideas. We have been way behind the curve on it and I think the sooner we change our attitude the better off we all will be.

Chairman KASICH. Mr. Largent. Steve, before you start—Scott, you will get a gold medal for this performance today, but tomorrow we will have a world class group of experts on privatization, I would encourage you to come, including one expert from New Zealand where they have kind of led the world in terms of creative efforts at privatization. I encourage you all to be here.

Mr. KLUG. Mr. Chairman, this is difficult to replicate for the record so we did not, but I will be glad to bring this up to the table to show you. These are industry trends in the global power sector, which is the reflections of something Merrill Lynch did on privatization efforts in global energy holdings all across the world.

If you will see Hungary, the Ukraine, Czech, United Kingdom, France, Spain, Portugal, Mexico, Canada, virtually every place in the world except the United States itself. So if I can, let me have someone bring this up to the front so you can pass it around. I think that is an interesting map that will show you the kind of worldwide trends where frankly we are way behind the curve on.

Chairman KASICH. Mr. Largent.

Mr. LARGENT. Scott, I got a haircut at the House Barbershop and I can tell you why they are losing money. I have had some personal experience there.

Mr. SHAYS. We all have done it once.

Mr. LARGENT. I would like to ask you, if you have specific examples in these different areas of assets that have been sold, areas where we contract out services, when that was done, services that we used to do but we no longer do, functional conversions, and perhaps even some barriers that have been lifted? Some real world examples of how that is done? And the other thing I would like to ask you about is can you kind of walk us through the steps of what would be required to maybe contract out services with the IRS or walk us through the steps of getting rid of the helium reserves?

What kind of time frame are we looking at? What kind of legislation would be required, that sort of thing? Sort of some pragmatic questions.

Mr. KLUG. Part of it, Congressman Largent, is that each one of these presents a unique problem. So for example, if you look at the Power Marketing Administration, parts of it actually are in the Department of Energy itself. Some of the dams are owned by the Bureau of Reclamation. Some of the dams are owned by the Army Corps of Engineers. So one of the things that I think would be very tricky for this committee, as it moves forward to embrace some of these ideas, is that you have got multiple jurisdictions in every one of these situations. As Ms. Molinari knows, Amtrak has been discussed. It is the same kind of thing. You not only have issues that are in front of the Public Works Committee, you have issues that will touch upon a number of other different committees that have to be changed as well.

So I do not think any of these are going to be particularly easy to do, but I think if the Budget Committee would set the tone for the authorizing committees to say it is our intention to privatize the Power Marketing Administration, then I think someone, whether it is the chairman, Mr. Kasich, or Mr. Armey or somebody is going to have to figure out how you get all those committee chairmen or chairwomen in a room and kind of knock heads to make sure this all ends up on the fast track. Otherwise, what you are going to discover is that you get three of the steps done but when you do not get the fourth done, you cannot manage to actually accomplish it.

As I said in the beginning of my testimony, we really only have two success stories to point to, and a third one that is in the middle. Conrail was a successful program to convert much of the freight railroad business in the Northeast in the 1980's, which happened. And Comsat was an attempt to take some of the commercial satellites we owned and actually turn those into private satellite operations where the data would be sold.

Those have both been terrific successes. A lot of the concerns and a lot of the horror stories you hear about any of these other ideas, you can simply take out the criticisms of these and stick in Conrail and you can go back and find that testimony in the mid-1980's that would say it.

The United States Enrichment Corporation is the one that is currently in front of us that I think has gone well. There is some con-

fusion, frankly, that the original estimates on the United States Enrichment Corporation, was that the assets were worth, if it moves publicly, to about \$3 billion. The current estimates are closer to \$1.5 billion and we are trying to find out who was wildly wrong several years ago or who is wildly wrong today.

So one of the most difficult parts with any of these are trying to figure out what the optimum strategy gets to be, in terms of how you make it happen. Do you really want the most money up front? Do you really want to hold on to some of the dams, for example, or do you want to sell them off immediately? On the National Weather Service, do you still want the Federal Government to hold on to the satellite, or do you want somebody else to actually own and operate the satellite today?

I know Chairman Walker, for example, on the Space Committee has been discussing and exploring what would happen if you took the space shuttle mission and privatized it, and essentially had people run the space shuttle and had the Federal Government only buy time on the space shuttle when it had missions or experiments it wanted to do. And when the primary mission of the space shuttle was to put satellites in space for commercial operations, then it could be a for-profit organization, running the space shuttle, actually making money on it and then we do not have to maintain the routine costs to keep the shuttle operations running and going.

So I think the only thing that bans us in this committee is the limitations of our own imagination, and I think there are a lot of ideas out there that are still coming over the transom and frankly, my staff that has been working on this so hard the last several months has been frustrated because for every idea we get done thinking through two more come over the doorstep and we are trying to figure out how to make those happen.

Chairman KASICH. Mr. Stenholm.

Mr. STENHOLM. Thank you. Scott, welcome to the committee. You have given us a lot of things to think about very positively. In the National Petroleum Reserve, are you aware of an offer by private industry to manage that for free?

Mr. KLUG. No.

Mr. STENHOLM. You are not aware of that? You ought to check into it because I believe that rather than selling that reserve, that is a much more attractive offer to the citizens of the United States.

Mr. KLUG. I am mistaken, as I look at Mark, who shook his head at me. There is actually a standing offer from Chevron, which now operates 20 percent of the field, to completely manage the field itself. I still think, Mr. Stenholm, given the time value of money, there is a question of why we should do it that way at all. I think if we can get the cash up front, there is no reason to have that dribble-drabble in over the next 5 to 10 years.

Based on the analysis that Shearson-Lehman did back in the mid-1980's, their recommendation, which the Federal Government paid \$.5 million for, was to sell rather than to hold because you would maximize your profits by about 20 percent.

Mr. STENHOLM. I have seen a little bit different numbers and as we get into that one, I think there is reasonable debate as to how you get the best return on the investment to the stockholder, in this case the citizens of the United States.



Clearly, if we can sell it and that makes good sense for us, then it ought to be sold. But there are also numbers that show where you have an asset that is producing, it depends on what the price is. And then the question is going to be you get the cash up front for what purpose?

I am curious as to, in your privatization barriers, I see perhaps in Farmers Home where Farmers Home is prohibited from contracting out debt collection. I see your point there, but what is your point on ASCS and Soil Conservation? What are you getting at there, or what is the rest of the story there?

Mr. KLUG. We asked Congressional Research Service to go back and look at all the legal barriers they could find to any kind of privatization and downsizing. I have not looked at, nor frankly have I heard any discussion, about privatizing out any of the things that ASCS does, but somebody must have raised it at one point, because it is my sense—

Mr. STENHOLM. You are not aware of it?

Mr. KLUG. No, but it is my sense that if you look at many of these, these were defensive efforts put in the law when somebody had discussed privatization connected with one of these agencies at one point. But in all the ideas that we have had come through the door, I do not think we have seen a single thing yet with the Department of Agriculture.

Mr. STENHOLM. One area that comes to my mind is in the area of food safety and inspection that comes in periodically. The final question, and this gets into the philosophical discussion, when you talk about power marketing organizations and eventually get down to rural electrification, and then eventually you get down to a discussion that I have quite regularly now about so-called leveling the playing field, while at the same time recognizing that the reason for rural electrification in the beginning is still with us in many instances. And that is to provide the electricity to remote areas of our country at the same price you deliver it to those who happen to be fortunate to live in the city and able to buy it cheaper.

In many instances what is represented to us that if you sell these entities, and you deferred to that a moment in your opening statement, that the cost perhaps will rise, in fact will rise for those who now have the benefit of subsidized electricity. Then you get into the question that we often talk about is rural development.

So on the one hand, we are going to be taking something away that is going to create additional problems for rural small town America. And then on the other hand, we are going to be debating what do we do to, in fact, assist rural America with rural development? Is there a conflict there or how do we rationalize it? How do we rationalize if there is a conflict? If there is not one, what am I missing?

Mr. KLUG. I think there is a conflict and I do not think it is an easy issue. I think we are seeing the same kind of discussion going on in the Commerce Committee where I serve right now about universal toll rate averaging for rural telephone companies. That if you look, it is obviously going to be much cheaper, just based on the economics, to make a call from the north shore of Chicago than it is going to be from Darlington, WI, in my congressional district.

Darlington is the county seat of the most rural county in the State of Wisconsin, which I represent.

You see the same kind of questions now, frankly, in the whole deregulation questions affecting the utility industry, that if you get competition what you may see, for example, is—again, let me just break it to my neck of the woods because I understand it better. If you get Wisconsin utilities, which are low-cost producers, going into northern Illinois to pluck off industrial customers, you essentially then have high-cost producers left with essentially residential customers in rural areas whose rates are going to substantially go up.

I am not smart enough to tell you how, in either of those scenarios, you prevent it from happening. I can tell you that we have had a lot of discussions that we are all very aware of.

Now I have both municipal utilities in my district and, on the fringe areas, some rural electric cooperatives and I have had long discussions, and I may not necessarily agree with those people in every case. I think you want to guarantee that rural areas still have some way to be able to guarantee that their customers are going to have low rates. I do not know if you cross-phase these, so for rural areas you guarantee them their rates are going to be held harmless for the next 5 years and the next 7 years.

I have got to think there is a smarter way to do it without having a third of the Department of Energy's staff hanging around running dams in order to accomplish it. So I can tell you that I am sensitive to it because I have a number of rural areas and REA's and municipals in my congressional district itself, but philosophically I have to tell you that I think in 1995 it is absolutely crazy for us to be running any individual dams.

Mr. SHAYS [presiding]. Mr. Hoekstra, do you have any questions?

Mr. HOEKSTRA. Maybe just one question for my colleague across the way. What have you found out about Amtrak? Have you taken a close look at Amtrak? I know that in our district we are taking some hits on some of the proposed closings and I do not think that the issue is necessarily that we ought to pour more government money into it. But have you uncovered some things in looking at Amtrak that say that perhaps the costs are not in the routes that are run but in the way that we manage their business?

Mr. KLUG. I can tell you again, back to Wisconsin, one of the routes that has been eliminated is Milwaukee to Chicago. We have a number of small private railroad companies that would love to operate that route and think they could do it for substantially less than Amtrak does it today. The dilemma is, and Ms. Molinari can fill you in much better than I, that there are now barriers because what we really have is a freight system where Amtrak has primary access to do passenger rail on, that until you drop those provisions no private company can step into the breach. That is not only an issue from Milwaukee to Chicago, it is an issue from St. Louis to Kansas City, I know, in Missouri where you have the same kind of implications.

I think one of the barriers that we are going to have to look at substantially to allow Amtrak to compete are some of the labor laws that hang around its neck right now, where you have 6 years of severance pay for somebody who is transferred 30 miles, it seems

to me to be very difficult for Amtrak to compete with the private sector.

But I would urge, while she is here, in her committee, the one thing they could do to change for sure, I think, is in situations where Amtrak has walked away from communities, then Amtrak should not have any barriers in place to prevent private companies from going in to provide rail services.

Mr. HOEKSTRA. I have no more questions. Thank you.

Mr. SHAYS. Thank you, Mr. Hoekstra. Ms. Roybal-Allard, to be followed by Mr. Brownback.

Ms. ROYBAL-ALLARD. Mr. Klug, one of the concerns that I have is with regards to the difficulties in ascertaining the true market value of government assets. For example, the true market value of government assets such as the Postal Service and the Power Marketing Administrations [PMA's] are unknown. This situation could create a tremendous problem in terms of selling. For example, if the price is too high, you will not have any buyers. If the price is too low, it could result in a net loss to the taxpayer.

I think an example of that is what happened in Great Britain, specifically the case of British Telecom. A study has estimated that it was undervalued by as much as \$1.3 billion U.S. dollars and that the primary beneficiaries of this undervalued stock were the financial and underwriting communities, the reason being that the underwriters were able to buy any unsold stock at bargain prices. In essence, what it did was create a transfer of net national wealth to the finance community and to wealthy investors.

Has your task force dealt with any of these distributional issues? And if so, in what way?

Mr. KLUG. What we have done, for example in the United States Enrichment Corporation where these same questions were raised, is to actually hire an investment banking firm to handle the transaction itself. I think what you do is guarantee that when you use an investment firm, for example, to price it out, is to guarantee that they are paid, not a commission. So they essentially have all the incentives in the world to make sure that you reach the maximum price.

Let me give you one clear example. If we decide, for example, to sell the assets of the Naval Petroleum Reserve, the question is how do you figure out what the price of that is? It seems to me you could write the contract, for example, where you told somebody not only do they handle the transaction with the Naval Petroleum Reserve but, as part of the contract, they have got to price out some of the Power Marketing Administration regulations.

In any of these cases it gets very difficult, as you take apart any of these things, because not only do you want to make sure you get an adequate price for the Naval Petroleum Reserve fields in California, of which there are two, you want to make sure you get an adequate price for the natural gas field in Colorado or the oil reserves that are in Wyoming.

I think you can obviously end up in problems if you don't do this very carefully and you don't do it very diligently. But it seems to me I would recommend that the Federal Government do the same thing I would do if I was a private company about to go public, which is to hire outside firms to give you a solid analysis and a



price tag, which we have done in the past, for example when we hired Shearson-Lehman in the mid-1980's to do an analysis of the Naval Petroleum Reserve.

Let me also say if you do this right and it ends up being converted and goes to the capital market, who owns stock in many cases, of course, are retiree plans and individual citizens. So if you make sure that the incentives are there for an investment banking firm to price it correctly, on the back end who really wins are the individual investors, which are everybody in the world. It is just not rich Wall Street bankers.

Ms. ROYBAL-ALLARD. Would you see some sort of a phase-in approach?

Mr. KLUG. I think you would have to do this very carefully. And I think, for example on the Power Marketing Administrations, you really need to do it from simpler to more complicated. I do not think we know how to do it. They may differ from resource to resource. In some we may want to make sure that it gets spun off and sold to the customers themselves. And that is actually, after the Telecom experience in England, one of the things they did on some of the other conversions was to make sure that the stockholders were actually the customers of the company. I think that, in many ways, for example with TVA, may be the best way to do it eventually.

Ms. ROYBAL-ALLARD. This is my final question. The savings and loan experience showed that privatization does not allow the State to withdraw permanently from key sectors of the socioeconomic framework of our country because in hard times, the tab is picked up by the government. It is highly unlikely, for example, that the government will refuse to bail out a failing privatized Postal Service. Part of our responsibility, as Members of Congress, has been to tax and to legislate in order to spread the risk, and this function is even more critical during times of market failure.

My concern is that by privatizing certain functions, that the government is selling the assets but is still going to assume all the risk of a market failure. Could you address that issue, please?

Mr. KLUG. I think absolutely that is a very legitimate concern, and let me tell you one clear example is Sallie Mae, which is now a guaranteed agency. As a GSE, there is a lot of concern that if we spin Sallie Mae off and allow it to completely privatize, do we still ultimately stand behind it and its guarantees? I think if we are going to give people the opportunity to privatize it, then they have really got to take the assumption of the debt on themselves.

On the Post Office, we really have not spent a lot of time looking at it, and Congressman Crane has. I think the question about the Post Office really goes back to Congressman Stenholm's question about the distinction between rural areas and urban areas. I think if you eventually figure out a way to spin off a post office or parts of it, it is clear that competition may exist in large cities. It is not clear that you would have it in small towns.

But I think the question then has to be whether it makes sense or whether the Federal Government, in order to guarantee rural delivery in rural Texas or rural Wisconsin, still needs to hold an infrastructure in Chicago, in New York, in San Francisco and places like that to do it. So on the Post Office itself, let me tell you



I am hardly an expert on it. And again, I think we have to walk before we can run.

Let us see what happens with the Government Printing Office before we worry about the Post Office, and let us see if we can do the Southeastern Power Marketing Administrations before we can do TVA, because some are much simpler and those may give us the lessons to do the larger ones later on.

Mr. SHAYS. Mr. Brownback, followed by Ms. Woolsey.

Mr. BROWNBACK. Thank you very much, Mr. Chairman. Thank you, Scott, for coming in front of the committee. I really appreciate your efforts, what you have done.

A quick statement, I have privatized some governmental functions before at a State level. We privatized regulatory functions, the weights and measures, in Kansas. It was a very interesting experience from the standpoint that, for instance, on gas stations. We were having government employees check the pumps there, to make sure people got a gallon of gas. While we were doing it as government, about 60 percent of the time the people in Kansas were getting a gallon of gas when they bought it.

We privatized that function and had private companies that were certified by the State go out and do it, and the accuracy of the pumps went up to over 90 percent when we went that way. The cost to the government went down, but we did shift a portion of the costs to the private sector because now we required the gas stations to hire the people.

I noticed in yours, you do not look much in the way of regulatory functions and I am sure it is because there are so much other fruitful things here to look at that we have got to go through before we ever get to those regulatory functions. I think you have got a good start.

One point on this, and I would ask what your experience was, in dealing with the Federal Government as a State government to privatize, we had to fight through them. They really were not too appreciative of the concept. They finally let us do it if we would call it a partnership instead of privatizing. So we said OK, we will call it whatever you want to.

What has been your experience? It sounds like the Weather Service and people there are interested in going a bit further, but what about some of the other groups you have worked with in the Federal Government toward privatization?

Mr. KLUG. Actually, I have to tell you that our experience so far has been largely positive, that we have had people come to us and ask. I had a meeting several weeks ago with the chairman of the FCC. The FCC reauthorization will be up in front of the Commerce Committee in a short time.

He raised the question about, for example, we now require the FCC to inspect radios on ships. It is really an anachronism left over from the Titanic and other kinds of accidents, where you wanted to make sure that ships were licensed. And he said why, in this day and age, does the FCC actually have to have the staff to go out and literally inspect every radio on every pleasure craft in the United States? It would be much cheaper if we could figure a way to privatize that out, so that when somebody bought a license, a private firm could check to make sure the radio got done.

In the same way that I think there is a real question today on the FCC of whether you need to have the FCC still issue permits for ham radio operators, when there is clearly no interference with signals whatsoever. So the FCC, for example, and that is one other snapshot, is very supportive to try to move some of those regulatory functions out of the agency.

I will give you another example. For years the Department of Defense used to have a central purchasing facility so that whenever a PX on a military base wanted to buy groceries it had to go through the DOD warehouse system, which meant that some PX's ended up with 9-year-old frozen fish sticks.

We changed the law several years ago to now allow any PX on a military base to purchase from a local food distributor the same way any grocery store or restaurant could in a given area. That has been so successful that the Veterans Administration now wants to do it for VA hospitals and VA facilities, only to discover there is a portion of the law which forbids them to do it. So the VA now has come to us and say can you give us the same latitude that DOD has.

I think systemwide, while I think eventually we are going to clearly run into some fights on these ideas, to this point I think many department heads and agency heads look at this new Congress as an opportunity to jettison a lot of functions they do not want to do, and have not wanted to do for the last 40 or 50 years, but which have always been on their books and have always had somebody fighting to protect them, like the ham radio operators. Now if we can free the FCC from those tasks, I think it really allows us to shrink the size of some of those government agencies.

While they are under pressure to meet budgeting targets themselves, I think it really has opened their eyes to privatization ideas.

Mr. BROWNBACK. And getting their focus back to what their mission originally was.

Mr. KLUG. Exactly.

Mr. BROWNBACK. Thank you, Mr. Chairman.

Mr. SHAYS. I thank the gentleman. Ms. Woolsey, and then Ms. Molinari will be following.

Ms. WOOLSEY. Thank you, Mr. Chairman, and thank you, Congressman, your presentation has been pretty darn clear. In fact it's been clearer than a lot of the questions that have been asked of you today.

I don't want to suggest for a minute that I want to privatize the military, but as I look at the list of your privatization bills I notice that there aren't any proposals to privatize Defense Department projects or functions. I know that you are one of the leaders in your party for cutting waste in the military and you've had a lot of political courage and you've demonstrated a lot of leadership on this issue and I compliment you on this. In fact, I hope you'll join Chairman Shays and myself in trying to kill the Trident D-5 missile again this year.

But that's not what my question is about. My question is about any privatization of such functions as possibly the School of the Americas in Georgia where the Army spends \$14 million a year on this military school, or the civilian marksmanship program which

helps the NRA train Americans how to use guns. I would really appreciate some response on that. Why isn't that part of this?

Mr. KLUG. We just haven't looked at the Department of Defense only because there's so many agencies to do that it's not been one that we've had an opportunity to get to. Actually, I think the question and the two examples you gave us on the School of the Americas and the civilian marksmanship program is not whether they should be privatized but whether they should be eliminated.

Ms. WOOLSEY. Absolutely.

Mr. KLUG. Frankly, in both of those cases I think the sooner we save the money, period. I don't think we need to pay anybody to do the services.

Ms. WOOLSEY. But if we privatize then it will be eliminated.

Mr. KLUG. If you privatize what you'd really do is figure out somebody to run the program and I'm not sure who we'd give the contract to to run the School of the Americas.

Ms. WOOLSEY. Wouldn't somebody have to bid for it, and if they don't want it then it dies. We say, this goes out to the private industry or there's no such program.

Mr. KLUG. Frankly, in this situation if you look at a number of the projects we have here, whether it's the National Weather Service, Amtrak, or the Power Marketing Administrations, there are investors standing by who would love to see this happen because they think there's an opportunity to provide a service and make money on it and do it more efficiently than the government can. On the two examples you gave me I don't think we'd find a lot of competition. I think we can skip the intermediate step.

Ms. WOOLSEY. Let's do that. How about construction work or hazardous waste removal that the military is involved in now? Couldn't we privatize some of that?

Mr. KLUG. One of the reasons I'm convinced, as a number of my colleagues are, that the Defense Department has had such a tough time finding money for missions is that we've lumped so many other things into the defense budget that really aren't defense issues that we should pull them out. I think there's a good argument to be had that if you took those hazardous waste cleanup costs and took them out the Pentagon and found another way to administer them you'd get cleanups done much more quickly. And secondly, you'd really keep the Pentagon and the Department of Defense focused on its core mission, which is running the Armed Services.

Ms. WOOLSEY. Yes, but it is on their bases so I wouldn't suggest we take it away from them as their responsibility. But I think they could contract it out.

I want to skip quickly to the IRS. What would you think and would you agree that the IRS could collect the over \$5 billion of court-ordered and unpaid child support annually in this country? It's bankrupting the welfare system. It's cheating our children. And the IRS does have an 87-percent success rate. What would you think of doing that through the IRS?

Mr. KLUG. If you privatized it you'd move to private collection agencies rather than the IRS itself. I think the IRS has raised some questions about whether they should be involved in enforcing other laws other than income taxes. But clearly, if you're going to get a handle on the welfare situation in this country one of the first



things you need to do, and you're absolutely right on this, is to force people who aren't paying their fair share of child support to pay it immediately. And if they don't pay it there should be some very clear repercussions.

In that framework, it's obvious to anybody who's looked at the problem, you need to figure out a system to track people who cross State lines. Now whether you have the IRS do it, whether you do it every time you apply to work, for example, that you've got to fill out a Social Security form so we've got a central registry to see whether people have skipped State lines, we have to do it one way or the other. We've not specifically looked at that function being privatized.

Ms. WOOLSEY. Thank you very much.

Mr. SHAYS. Before calling on Ms. Molinari and then Ms. Meek, I'd like at this time to ask unanimous consent that the gentleman's full statement be printed in the record, if there's no objection. [No response.]

Ms. Molinari.

Ms. MOLINARI. Thank you. First of all, Scott, let me congratulate you on this tremendous documentation. Clearly, as Ms. Woolsey said with response to your responses, you know what you're talking about. We appreciate the work that you and your staff have put into this.

You sort of answered my question with regard to your response to Mr. Hoekstra's in terms of acknowledging as we deal with the Amtrak system—and certainly, our bottom line fundamentally wants to privatize those lines that we can privatize, to eliminate those lines that need to be eliminated, and then to take a clearer look at the picture, acknowledging that none of that can be done until we change the Federal labor statutes so that this may be several years in terms of labor statutes and then contract negotiations. I was wondering if you've incorporated that timeline into your recommendations.

Mr. KLUG. We've not incorporated in the timeline. But the one point I'd make, and it's something you're very cognizant of, is the problem with political interference with Amtrak. Amtrak has never really been able to, although it finally may be able to now under Chairman Downs, to evaluate which parts of Amtrak make sense and which don't. It's much like the situation with military bases. Everybody is in favor of closing down military bases unless it's the one in their corner of the world. Everybody is in favor of privatizing unless it happens to be their Power Marketing Administration. Everybody is favor of Amtrak cutting back services unless it happens to be their train station.

If there is one thing you could do is to figure out some way to isolate Amtrak's economic decisions from the political process. Clearly, the Northeast has been a great success. Some of the lines in California have been a great success. Some of the cross-country routes have been an absolute disaster. They've existed not for economic reasons, and frankly, not from Amtrak's decisionmaking process, but because we have forced them to.

We've got to figure out a way, it seems to me, to make sure that Amtrak is insulated from political decisions when they begin to make their economic calculations. I think Amtrak, in contrast to

some of the other people under pressure to privatize today or be eliminated, have been very innovative and I think would be very creative if we could just give them the flexibility they need to respond.

Ms. MOLINARI. I couldn't agree more. It's ironic when you talk about all the labor requirements that have been imposed on them by Federal statute, and the fact that that they are not allowed to close a line without coming back to Congress to totally eliminate a line really puts a tremendous amount of pressure on them. Hopefully what we're going to do in this reauthorization, Scott, is to take a look at a way to free them of all those Federal restraints so that they can in fact function like an independent and private business and then take a look at privatization. I just wanted the acknowledgement for the record that this may take a year or two until we enable them to make those changes.

Mr. KLUG. Absolutely. I think Amtrak is willing to make decisions, given the new review that's been going on, of their lines and of their costs and of their attempts to set up private—not private, I shouldn't say, but additional maintenance contracts outside of the normal scope of business. It's going to take a while to get there. But again, I think the one thing they need more than anything else is political courage to allow them to make those decisions.

Ms. MOLINARI. Absolutely. Thank you, Scott.

Mr. SHAYS. Thank you, Ms. Molinari. Ms. Meek, to be followed by Mr. Allard.

Ms. MEEK. Thank you. First of all, I'd like to commend my colleague, after having heard him the second time, first in the Governmental Operations Committee, on the scholarly way you have approached it and the candor with which you have answered our questions. I seem to feel from what I'm hearing that there is perhaps a move on to investigate, at least to review, the validity of privatization.

As I read through your papers here I see that you have an agency which I have had some experience with having been on the Energy Water Subcommittee, and that is the TVA. Certainly, that is an agency that does need some clear oversight in terms of spending taxpayers' money, in that it does everything from slice bread all the way up to what the TVA is purported to do. So I think that has quite a bit of validity.

My question is, if we do have a process for doing this, in the end I think the process should be one that's implemented incrementally. If we're using it as a budget cutter, and I think that's what we'll use it as originally, let's look at the big ticket items, the ones that really bring in lots of revenue and ones that really cost a lot, like the TVA for an example, and the ARC. I don't think we should start with the small groups that you have in here. I think the process should be one to start with large ones that are really going to bring a cost-saving effect to the government, instead of the little ones.

Also we have to look at the fact that we are dealing with workers here. We're working with people on the other side of the spectrum. Each of us is a politician and we do have people on the other side. Hopefully those people will be taken into the process if it's done incrementally and that some kind of impact study will be done. I

really ascribe to some of the remarks made by Ms. Molinari, that we should do this slowly; we should not jump into this. But I do think privatization has some merit, particularly with the large ticket items.

Mr. KLUG. One of the great experiences that reinforced for me the difficulty in doing some of these was a decision in the Senate to specifically exempt TVA from the balanced budget amendment considerations. Although I can't trace back where it came from, I would suspect one of the two Senators from Tennessee are a logical conclusion.

You're right in terms of the mission of TVA. The problem has been with a lot of these agencies that you initially defined a very narrow mission. Then over time the mission began to change to guarantee it would stay in business. I think the rural electric co-operatives are a clear example; originally set up in the 1930's to guarantee rural areas had power. Then suddenly they became an agent of economic change to the point now where they've helped develop Hilton Head, SC, and some of the ski resorts in Colorado. That was not what Congress had in mind in the 1930's when it set up the REA.

I think you look at all the things TVA does today, from environmental issues down to economic development, again that's not what we had in mind in the 1930's when we decided we'd use those dams to get people electric power.

Ms. MEEK. Thank you.

Chairman KASICH [presiding]. Mr. Allard.

Mr. ALLARD. Thank you, Mr. Chairman. I'd like thank Congressman Klug for his good work in this area. I think we need to look at privatization as a viable alternative. There are some areas that you didn't include in your testimony that I've given some thought to and I would like to bring those up for discussion. For example, laboratory services. The Federal Government provides a lot of laboratory services and I wonder if perhaps maybe that wouldn't be an area where we could easily privatize out. Another area, some of the functions that are performed by the Environmental Protection Agency. That's one agency that does provide laboratory services. Also comment on the National Biological Survey.

Those agencies that do research, why don't we contract those out to the universities and have peer review, they probably would come up with a better scientific conclusion than a Federal agency which has their own agenda to pursue? I wonder if we wouldn't be better off and why you haven't looked at some of these.

Mr. KLUG. I can tell you that a number of the Wall Street investment banking houses which have looked at some of the issues we've discussed here today, Power Marketing Administrations and NPR to put price tags on them, have looked very closely at Department of Energy labs. That it's their sense that if you were going to spin off some of the labs that the Department of Energy may be the richest target to examine. I think you're right to put your finger on it. That's one of the ideas that's come in the door we haven't had an opportunity yet to fully develop.

Let me also say that if you look in here one of the ideas that we've clearly identified are some of the wind tunnels used by NASA to allow the commercial aviation industry to test new aircraft de-



velopment. In the rescission package that we're about to adopt we've cut out \$400 million in funding for a new wind tunnel. The wind tunnels now operated by NASA are so inefficient that increasingly more and more work is done overseas.

I think the question has to be, if the aeronautics industry in the United States needs a new wind tunnel to do research that should be done by private industry, it shouldn't be done by the Federal Government. In fact, I think one of the first steps we could do is to see if anybody has any interest in the three that already exist to sell those off.

Mr. ALLARD. Let me suggest something. Some universities have wind tunnels. We need to keep that in mind. They may not always be the most efficient but they might be a better alternative than the agencies if you can't find a private contractor.

Mr. KLUG. But you're absolutely right on some of the labs and the Department of Energy is one of the first places I'd look.

Mr. ALLARD. I've heard veterans hospitals mentioned as a possible privatization. You didn't have this in your presentation either.

Mr. KLUG. We didn't look and, Congressman Allard, it's just a function of there are only so many hours in the day and so many things. The question with the VA hospitals it seems to me that that's a larger question as part of health care reform, and part of the larger discussion about vouchers.

For example, right now the Department of Housing and Urban Development and Congressman Rick Lazio from New York has been very aggressive in trying to move HUD away from public buildings and instead to a voucher program to allow people to take those services and really go someplace else. It seems to me that's really the more appropriate discussion for the VA hospitals, is if we close the VA hospitals down can you still deliver those same services? I'm not really an expert in that field so I hesitate to speculate.

Mr. ALLARD. Let me bring up the issue on the rural electrics. They have made the comment that we wouldn't mind giving up some of our loan subsidies if we had the same tax benefits on the other side that public utilities and individual-owned and investor-owned utilities. You're a member of Ways and Means which looks at tax policy. Do you think that might be a viable alternative when we're looking at the possibility of reducing interest subsidy to REA's that you maybe give them the same tax advantage that you would a public utility.

Mr. KLUG. You may want to do that. Actually, I'm on Commerce, not on Ways and Means. But I know a little bit about it.

One of the great barriers I think REA's have today is the fact they're not allowed to pay back loans early. If you looked at the loan climate we've had over the last several years, had REA's had the ability to switch loans to the private sector I think they could have paid off a lot of debt early and been able to recapitalize and do some other kinds of projects they'd like to.

I don't think there's any doubt in the world that there's still a need for the REA's in some form or fashion. Frankly, again, we've tied their hands as we've tied Amtrak and a number of organizations by political interference. I think in order to make sure that REA's exist in the future you're going to have to make some changes, including perhaps tax changes and including the possibil-



ity that they can pay their loans back earlier in the private marketplace rather than being tied to long-term government notes.

Mr. ALLARD. It seems to me that what I'm getting from your testimony is that maybe we need to look at getting rid of language that says agencies can't look at privatization as an alternative. It seems to me like we don't need to force the agencies. Just give them that option out there and they'd begin to move much further on their own without us having a lot of legislation.

Mr. KLUG. Absolutely. I think again, given the budget constraints and given the fact that they're all under pressure to shrink, the only way they're able to accomplish that is if you begin to jettison services and to jettison functions of things they do.

Chairman KASICH. You guys must have come to work on a turnip truck if you think that the bureaucracy is going to unleash their control over this stuff in an effort to try to save money.

Mr. ALLARD. Mr. Chairman, there's the administration part of the Federal agency, and of course, you've got the employee part. But I think the administration in many agencies, despite their party affiliation, want to look at what they can do for the people that they serve. I think that it's not unusual for them to look at ways to cut costs so they can do a job. I don't understand why we don't take that—why would we take away from them an opportunity to make these choices? There must have been some concern in the Congress at one time or another or they wouldn't have even had this in the legislation.

Chairman KASICH. I would say to the gentleman that there should be no prohibition against it. But I guess what I would ask the gentleman is if he could cite me a couple examples of where bureaucrats wanted to privatize the operation of something and where they were just gung-ho to do that.

Mr. KLUG. Actually, you had stepped out of the room, Mr. Chairman, briefly while I was discussing some of those. The FCC, for example, has put on the table a number of functions they'd like to get rid of. They're required, for example, today to inspect every radio on any kind of ship or boat in the United States. They don't want to do that any longer. It costs them a lot of manpower and money to do that. The FCC, for example, is required today still to license ham radio operators. They don't want to do that; privatize it out. You really don't need to do it. In fact, they may not even need a license any longer.

I disagree with you in that, I'm not naive enough to think that the Department of Energy is going to come and say, sell off all these assets, we don't want to do this anymore. Anybody who's involved in a bureaucracy fundamentally protects their own empire. But I also think you underestimate, again, given the fact they're all under constraints to shrink their budget 10 or 15 percent. It's oftentimes easier for them to jettison service as it is to cut their own internal bureaucracy. So I think in some ways you may have allies where you don't expect it.

Chairman KASICH. We clearly ought to lift these prohibitions where they want to do things. Maybe I should be a little more optimistic. The gentleman from Florida, Mr. Johnston.

Mr. JOHNSTON. Thank you very much, Mr. Chairman. Congressman Klug, I, like my colleagues Congresswomen Meek and Wool-

sey, appreciate your candidness, also your command of the subject, and finally your intellectual honesty. I've supported you in the past on your advanced solid rocket motors. In fact, I think we voted for that several times over the last several years.

I guess TVA is just too politically sensitive to attack under the umbrella of the others; is that correct?

Mr. KLUG. No, it's certainly not for me.

Mr. JOHNSTON. No, not for you but for political—no, you've gone after a lot of windmills here today and I appreciate it. Congressman Allard was talking about rural electric. They came in, they're very big in north Florida. They had five points and their first four were get government off our back, and the fifth one was, whatever you do, do not privatize Southeast Power. And I said, yes, government does some things better.

If I can make a suggestion, because the things that you're going after are probably as politically sensitive as trying to balance the budget. Maybe the base closing model is the model into which you throw this effort to depoliticize it, because I appreciate the fact you said you had to walk before you could run there. You might consider that.

The one area that I think privatization fails is where there's not sufficient private competition. One example, in my county, we privatized our road building and bridge building only to have the local contractors then clobber us over the head because they had a monopoly. I don't think you'll find that in the printing office, and obviously there's enough competition within the beltway to resolve that.

Could I ask you about your task force? Are you chairing the task force?

Mr. KLUG. Yes.

Mr. JOHNSTON. Is this a Republican Party task force?

Mr. KLUG. Actually, it's not been a task force at this point as much as it's just been an effort by my office at Mr. Gingrich's request. But we've worked with a number of Members. For example, on the national helium reserve we've worked closely with Chris Cox from California, and Barney Frank's been a big help to Chris over the years. We've worked with Dick Zimmer from New Jersey on the petroleum reserve and I worked with Mr. Brownback and Mr. Sanford and a number of freshmen this morning on privatization ideas in-house.

So if that's a question whether any Democrats can get involved, the answer is absolutely.

Mr. JOHNSTON. Good, because I don't think Democrats and privatization are an oxymoron, and you might consider approaching some of them.

Finally, in reference to what was said earlier, the EPA has got about \$1.2 billion worth of consultants out there that are there without bidding process. That's something you should look into.

And finally, maybe have a task force, again on mining, a task force to look at tax subsidies. I know they're very, very sensitive but I think you have the political will to pursue that and I appreciate it. Thank you.

Mr. KLUG. I think, again the mining break is absolutely scandalous and it's a loophole we have to close. Let me also suggest to the

chairman while I've got his ear for a minute that if we're going to look at a base-closing model, one agency in particular that I think should be closely examined is the General Services Administration.

I think, above and beyond the recommendations in this report, we should put an immediate freeze on construction of any new GSA projects and secondly set up a base-closing commission to tell the GSA to sell off 10 percent of its assets across the United States. When you have a double digit vacancy rate in most commercial real estate markets in the United States, there is no reason in the world for the Federal Government to A, build new buildings or B, hold on to properties that can't be justified. I think a base-closing commission model would be perfect to apply to the General Services Administration to force them to make the tough decisions.

But rather than have us micromanage which buildings where and how, much like Ms. Molinari's problem on Amtrak oversight, we've got to give the GSA a hammer over the head so they can use a hammer to hammer their own people.

Mr. JOHNSTON. Finally, if I could say, you talked about Amtrak and how you need to cherry-pick that. Again, this model could do just that; go in and close this, close that, but keep that. I think that's the only way you're going to get from here to there.

Mr. KLUG. I agree.

Chairman KASICH. Mr. Shays.

Mr. SHAYS. Representative Klug, I knew you were testifying today and I came out of respect for the effort you've done, but I've really found this to be one of the most interesting hearings our committee has held this year. I do, because I think you are an incredible—first, you have tremendous command of this issue. But I think the issue itself is extraordinarily important and you can have a magnificent impact on what we do. I'd like to second Mr. Johnston's request that you formalize this into a bipartisan task force because it seems to me your knowledge can be transferred to others. But your challenge now is to break the barriers, the political barriers.

I was going to ask you questions on the GSA. I'm intrigued by the thought of doing a moratorium. I'd probably like that, a moratorium on GSA activity more than I do on regulations. What would be the result of a moratorium?

Mr. KLUG. Actually, I had a conversation last week with Congressman Gilmore from Maryland who heads the subcommittee that looks at GSA. I think we really need to have very tight scrutiny on any new GSA projects. My sense is unless there's a compelling reason, there shouldn't be a new government building built anywhere where there's a vacancy rate above 7 or 8 or 9 percent.

Mr. SHAYS. But as it relates to moratorium, there are contracts—for instance, I wanted to stop this building, the great hole, a few years ago that's now become—

Mr. KLUG. On 10th and Pennsylvania?

Mr. SHAYS. Yes.

Mr. KLUG. I agree with you.

Mr. SHAYS. We found that there were commitments and so on that lasted for years. So would the moratorium be on any new planned projects? Because I don't know if you could financially stop a project that has already had the financial commitments.



Mr. KLUG. I suspect you're right. I think it would just have to be a moratorium on letting out contracts for the new design or new construction of any buildings.

Mr. SHAYS. I'd like to go onto a bill tomorrow, if you'd put one in, to do that. Maybe we could even ask the White House to put an executive order out to do that.

Mr. KLUG. I think that's a terrific idea and we can talk after the hearing gets done.

Mr. SHAYS. Thank you. I yield back my time.

Chairman KASICH. Mr. Pomeroy.

Mr. POMEROY. Thank you, Mr. Chairman. Congressman Klug, thank you for your very interesting testimony. Relative to the rural electric co-ops and the PMA's there's a couple issues that I want to bring you up to date on. We did get prepayment of loans approved last session of Congress. So that statement, while it was true at the beginning of the 103d, thankfully is no longer true. That, by the way, was a statutory and a budgetary issue, not so much a government versus privatization issue, for those of us that struggled to get that repealed. It was an OMB issue primarily.

The PMA's are really a big deal. Just members of this committee, for an example, that have a stake in this question are 303,000 Coloradans, Floridians 150,000, Brownback in Kansas will be 166,000 people, Minnesota 521,000, one-sixth of all North Dakotans potentially impacted by PMA power.

Your statements here seem to tell about half the story. You lay out net appropriations without detailing net revenues received. Now it's my understanding that these are being run on a no-cost basis. That in fact, the cost of the power is charged out in the electrical rates ultimately sold; is that correct?

Mr. KLUG. My understanding is that most of them recover a substantial portion of the appropriated funds they have.

Mr. POMEROY. Actually a substantial portion, for clarification, I think 100 percent.

Mr. KLUG. I think you have to do them one by one, and I'm not sure if that's true for every single one.

Mr. POMEROY. Let's talk about WAPA, the biggest one. I think that's 100 percent.

Mr. KLUG. I believe you're right. I don't know it for a fact.

Mr. POMEROY. So really reflecting a fiscal year appropriation of \$266 million without a notation as to the revenues received isn't quite the whole picture.

Mr. KLUG. But I think you have to ask, the philosophical question is whether the Federal Government should still be running the dams and collecting that revenue, period. Why are we even in the business of being toll-takers?

Mr. POMEROY. We'll get to that. That's an interesting philosophical question. The only thing more interesting than the philosophical question is the rate impact. Because my consumers, while they're interested about philosophy, are more interested in monthly cash flow, and I think that's generally the case.

Here on the next page, page 6 of your testimony, I'm very intrigued to see that you suggest the rates will come down, interjecting competition through the sale of the Power Marketing Administration. Is it your position these things will reduce electrical rates?



Mr. KLUG. Across the country, yes.

Mr. POMEROY. Is it your position that for the consumers of the Power Marketing Administrations at issue, particularly the WAPA because that's the one I'm most concerned about, is it your position that consumers whose electricity involves a portion of WAPA power will find lower electricity rates as a result of the sale?

Mr. KLUG. It may be that in some cases in some of the WAPA territory rates could do up. But the bottom line is that there are many more Americans who pay for the power administrations than are served by it.

Mr. POMEROY. How is that, Mr. Klug, if these things are run on a no-cost basis? In fact, you and I have agreed that WAPA does not involve a taxpayer subsidy.

Mr. KLUG. It involves substantial taxpayer subsidies for loans which are still on the books.

Mr. POMEROY. If the loans are being repaid, how are they being subsidized?

Mr. KLUG. They're below market loans.

Mr. POMEROY. Because the interest rates at the time the parties negotiated the contracts are presently not at market level? That happens all the time, doesn't it, in the public or private sector?

Mr. KLUG. It may happen in the private sector, but in that case taxpayers across the country aren't paying for it.

Mr. POMEROY. You're the government and I'm WAPA. We enter a contract at a loan rate. Now that loan rate ought to be good for the life of the contract, ought it not be?

Mr. KLUG. Certainly. But the question has to be, in this day and age why the taxpayers of the United States are subsidizing below market loans to Power Marketing Administrations.

Mr. POMEROY. Because the government at the time the agreement was entered into committed for the life of the contract at that loan rate. Now if government is to be run as a business according to a concept of privatization, don't you think government for a start ought to honor its contracts?

Mr. KLUG. Mr. Pomeroy, I think the operative phrase is, at that time. I think the question has to be whether 1995 still justifies nearly a third of the Department of Energy's staff, with appropriate fringe benefits and insurance and everything else, whether the taxpayers of America still need to support that infrastructure to provide electrical service which I think can be filled in by competition today.

Mr. POMEROY. There's another concept of subsidy when you come to dams. North Dakota lost half a million acres. It now sits under a reservoir; a one-time flood that didn't leave. That's kind of an on-going subsidy by the people of North Dakota for Lake Sakakawea behind the Garrison Dam. It was constructed with public funds. It took definite resources for North Dakotans. And if in fact that generating facility can at a no-cost basis provide power, what's the problem with that?

Mr. KLUG. Again, I think the question has to be, and I'm back to the fundamental question is whether in 1995 the Federal Government should still own and operate dams when it seems to me we clearly have the opportunity to lease them back or sell them off. And the bottom line has to be not necessarily what's good for North

Dakota or Wisconsin or Ohio, but what's good for the country as a whole.

Mr. POMEROY. In my opinion, there are a lot of people here that are resolved not to raise taxes, not to raise the cost of government on the citizens of this country during this session. I'm one. And to have us sell facilities that result in higher electricity rates because we now have a private concern that needs to generate a profit margin, as well as covering return on the cost of investment, seems to me a backhanded way of actually increasing the burden of government on—

Mr. KLUG. If your assumption is the government can do it more efficiently, then perhaps we should nationalize the electric industry in the United States.

Mr. POMEROY. Of course, I don't take that position. But I do take the position that when we've got something that's working, selling it because of a philosophical bent, with the inevitable rate shock to the literally millions of people that receive power from those facilities is bad business.

Mr. KLUG. One of the arguments you'll hear, for example, on TVA or Bonneville Power Administration is to say, wait a minute, we've invested in some nuclear plants that haven't paid off and if you remove our exclusive territory regions our rates may rise dramatically because we've made bad investments in utilities. And my answer would be is that we've artificially depressed those prices and they don't reflect true market conditions.

Again, my sense is if you average out the power at hydroelectric dams and apply it to the rest of the country that you may find, strangely enough, that Duke Power, for example, in North Carolina may be able to sell rates to Tennessee customers lower than TVA can today. We don't know.

Chairman KASICH. Does the gentleman have one more?

Mr. POMEROY. By closing I would just say, I think that the concept of privatization is a very attractive one. I commend you for your leadership and work on the issue. Yet, it is a concept that is no stronger than the actual property under consideration. It is my strong feeling that the strength of the concept begins to break down very severely when applied to the Western Area Power Administration. Thank you.

Chairman KASICH. I want to thank the gentleman from Wisconsin for being here today. The gentleman from Michigan will have full opportunity tomorrow when he comes to the hearing to be able to ask these experts from all over—one guy from New Zealand. Do you have a quick question, Mr. Smith?

Mr. SMITH OF MICHIGAN. No, I'll ask him privately. He's done a great job.

Chairman KASICH. Thank you, Mr. Klug, for being here and the committee will stand adjourned.

[Whereupon, at 11:43 a.m., the committee was adjourned.]

## PRIVATIZATION

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WEDNESDAY, MARCH 1, 1995

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON THE BUDGET,  
*Washington, DC.*

The committee met, pursuant to call, at 10:15 a.m., in room 210, Cannon House Office Building, Hon. John R. Kasich (chairman of the committee) presiding.

Members present: Representatives Kasich, Smith of Texas, Alard, Lazio, Smith of Michigan, Inglis, Hoke, Molinari, Hoekstra, Largent, Myrick, Brownback, Shadegg, Bass, Sabo, Stenholm, Costello, Johnston, Pomeroy, Browder, Roybal-Allard, and Meek.

Chairman KASICH. We are going to get started. I wanted to welcome the witnesses this morning. We have got Bob Poole, who is the founder of the Reason Foundation, a national public policy research organization. He has done an awful lot of very interesting work. Tony Dale, who is the Budget Director for the New Zealand Government, and he is on leave from his position with the New Zealand Treasury and was in New Zealand as they have marched through privatization. And Prof. David Linowes from the University of Illinois, also another leading expert in the country on privatization.

I would say that I am going to have to leave in a few minutes to go into some meetings with the Speaker and I am going to regret missing this, because I think there is going to be a lot of fascinating information that is going to come out here this morning.

This is a chart that I put up because whenever they use this kind of imagination, I always like to avail myself of their efforts. The red line indicates the cumulative sales of state-owned enterprises around the world. The interesting thing is that even Khaddafi has taken to privatizing his camel operation in Libya. That is why we have got the camel up there.

I think the effort at trying to privatize obviously makes a lot of sense and I think we are going to hear a lot of very interesting things this morning. I want to start with Professor Linowes, and he will be the first one to testify. Professor, after Mr. Sabo makes his comments, the floor is yours.

Mr. SABO. Welcome.



**STATEMENT OF DAVID F. LINOWES, PROFESSOR OF POLITICAL ECONOMY AND PUBLIC POLICY, UNIVERSITY OF ILLINOIS, FORMER CHAIRMAN OF THE PRESIDENT'S COMMISSION ON PRIVATIZATION**

Mr. LINOWES. I am pleased to be here and participate in this hearing. Much of what I will say is based on the findings and recommendations of the President's Commission on Privatization. President Reagan had established that Commission and it has been 7 years now since I presented the report of findings and recommendations to him and to the Congress. Everything that is contained in that report is just as relevant and timely today. I will just hit on some appropriate highlights that I think should require early action.

All privatization actions involve one or more of several dimensions. First, government should reach out by opening its operations to bring in the creative talents in the private sector. Only those who work in government are allowed to help solve the needs in medical care, education, poverty, and budgetary deficits.

Our Nation is trying to cope with some of the most intractable problems with one hand tied behind its back. The creative talents and ingenuity of those in the private sector are excluded from direct participation unless they quit their jobs and go onto the government payroll. Yet, those entrepreneurs in the free enterprise system are among the Nation's greatest resources. That is not a reflection on those that work in public institutions. The problem in government institutions is with agency structure and legislative restrictions. Congress has a penchant for micromanaging many of the government agencies.

We can and should use private sector entrepreneurs to achieve more effective government performance. We can do that by contracting out many of its operations. I know this is an issue that you have been concerned with yourselves and has been getting much exposure.

I think it is important to recognize that one-fourth of the government work force performs functions that compete with, and are similar to, work performed in private business. Cutting back this slice of the public bloat would contribute toward concentrating government on governance, where it belongs.

A second dimension of privatization is that consumers who require government services should be given a choice and not be captive to a particular agency—the public school, medical clinic, or housing project—to which they happen to be assigned. Choice injects an environment of competition, the powerful force of the marketplace, in the delivery of social services.

Public school students should be given education vouchers, freeing them to attend the public schools of their choice. Many jurisdictions now have adopted, or are in the process of adopting, some form of school voucher system. It is worth noting that public schools' average cost per student per year is \$5,400. Private schools' is \$3,900, \$1,500 less. Yet, it is generally conceded that the education obtained through private schooling is superior to that through the average public school.

Low-income families should be furnished housing vouchers so they can select living accommodations of their choice and need.

Housing the poor has been a failure. For over 60 years our Nation has attempted to satisfy the needs of low-income families by furnishing them public housing and some subsidized programs.

It is interesting how we got into that business. It was during the great depression. President Franklin Roosevelt realized there were many homeless people and something had to be done. His advisors debated whether it should be in cash or a form of voucher or building public housing. The public housing advocates won out. It seems to me it is time to consider a change.

We have 1.3 million public housing units. Two-thirds are in substandard condition requiring an outlay of \$25,000 on average per unit, or over \$20 billion. Many of these housing projects are overrun by drug pushers and muggers. Others have been demolished after only 12 or 15 years, such as in Newark, NJ, New York City, and St. Louis, MO. These buildings had been constructed with a life expectancy of 40 to 50 years. The reason for the need for demolition is vandalism, and just complete neglect by the tenants themselves.

All tenants living in substandard projects should be supplied expeditiously with housing vouchers so they can go into the marketplace and successfully compete for the kind of housing accommodations they require, away from the stigma of being housed in free housing given by the public.

We can provide three housing units with vouchers for every housing unit that is produced by building public housing projects; 10 million low-income people need help and they are not getting it. A massive shift in resources toward vouchers would help significantly.

The Medicare program was initiated in the latter part of the 1960's as part of the Johnson administration's agenda for the Great Society. Like Social Security, Medicare was conceived, not as a form of public assistance, but as a form of forced savings, to be returned as a benefit in later years.

The Medicare program faces a fiscal crisis. Because of increased consumption and the use of more elaborate technology, medical costs have been increasing at a much faster rate than inflation.

The major cause of accelerating health care is the lack of cost-containment incentives. Because consumers do not directly pay the major cost of medical care, their decisions about whether to consume medical care involve virtually no consideration of that cost. Health care providers have little incentive to compete on a price basis. Although there may well be benefits to consumers from the nonprice competition that presumably results, much of health care quality is difficult for consumers to gauge and it is unclear how much real quality competition exists.

Private sector competition, by means of vouchers, in health care financing can provide critically needed cost containment as well as incentives that offer a broader choice of health plan options. The government should act to increase competition and provide sector participation in health care by encouraging the use of vouchers and/or capitated payments.

A third dimension of privatization is that government should not be in the business of business. Our Nation should not be a \$200 billion money lender. Interestingly enough, at the time of our Com-

mission deliberations, it was \$250 billion. The government has been withdrawing from that function gradually.

Government has set up large bureaucratic agencies to make direct loans to homeowners, farmers, students, business persons. These same types of loans can be handled by banks who could be contracted to charge the same low costs to the borrowers, and soft rates, the government paying the difference between the charge and the market price.

We have a well-developed banking system with established administrative procedures who effectively compete with one another. They are well qualified to take over the functions and administer it. It would handle administrative detail only, not policy. Presently, the default rate for government administered loans is three times that of private operations. The reason is quite simple. They just do not follow up when the payment is due. They send a notice once and then do not follow up.

Not long ago there was an exposure of many of those earning over hundreds of thousands of dollars a year on Wall Street who had loans from their college days but never had paid them because they were not contacted to make the payment.

Producing oil belongs in the private sector. Naval Petroleum Reserves in Elk Hills, CA, and Teapot Dome, WY, should be sold. The original reason for being acquired by President Taft has long passed. We can realize, it is estimated from both, a gross of at least \$4 billion. The wells were acquired at the time the Navy was shifting from coal for its power to oil. This oil in these wells is heavy. It cannot be used for aircraft.

The many billions of dollars freed up from these and similar government-owned inappropriate assets could better be invested in reducing the deficit or in better schools and housing.

In discussing dimensions of privatization, a caveat is necessary and something that too many critics of privatization overlook. Government should never abdicate responsibility for making policy and monitoring standards that affect the public welfare, even when the operation of a function is turned over to the private sector. Thus, if air traffic control were to be contracted out to private business, the Federal Aviation Administration would still be in business. It would always have to be there to continue setting policies and monitoring performance.

I think it is important for me to identify some of the primary reasons the private sector is so much more effective than government operations, especially for people who are inclined to be concerned about changing.

There are essentially six reasons. First, government ownership or control involves political influence on the goods and services that are produced, on the investments in facilities, and on personnel policies. When such decisions are based on political expediency rather than objective facts, the results can be and too often are destructive.

And incidentally, with reference to those oil wells, the administrators themselves testified before my Commission that they operate quite ineffectively and inefficiently, because the government does not invest in enough equipment to be able to produce the oil properly.



The second reason is that a government operation is usually protected by a complete or partial monopoly and thus misses the drive that competition stimulates. A private firm has to keep the costs down and its output attractive or it loses its market. This is not true in a government monopoly.

Third, competition gives a consumer a choice, increasing his options, and thereby stimulating increased consumption. That is what advertising and public relations do, stimulate people's interest in acquiring and purchasing more.

The fourth reason that private sector is superior is that a government operation which fails to satisfy its customer does not risk going out of business. A private firm does. Therefore, it aggressively strives to satisfy the consumer.

In government operations, consumers' interests are subordinated to the interests of the owner, that is the government. In business operations, customers' interests are paramount or the customers leave. Quality and price are key concerns of the private operation.

Finally, a government agency does not have the drive to keep abreast of the latest technology, or to find the latest cost-saving developments, or to innovate. Government operations generally do not have these pressures, nor do they have the funds with which to experiment and research.

It is ironic that government ownership and operation was conceived as a way to give the people better goods and services at lower prices. The argument was that without the costs of profits, competition, and advertising they could outperform the private sector. The fact has been the reverse. Without the competition and commercial pressure, government operated facilities have been less effective as well as more expensive.

In considering change, I am aware that the American people do not embrace initiatives that depart too widely from their traditional experience, and I think that is especially important to keep in mind when we talk about possibly privatizing major functions in our society. Therefore, incremental transfers to the private sector should be provided for. The approach is to build upon gradual successes. I would like to give you a couple of examples of how this can work.

In the Postal Service, a number of functions are overdue for private sector involvement. Statutes mandating postal monopoly for first- and third-class mail should be repealed. When restrictions on urgent or overnight mail was lifted in 1979, we witnessed the dramatic growth of Federal Express, Purolator Courier, DHL and others. The U.S. Postal Service now serves only about 12 percent of the express market. A number of years ago, it served the whole 100 percent.

It is interesting to note that some time ago when the Postal Rate Commission recommended increasing first-class mail by three cents, at that time from 22 cents to 25 cents, it also recommended that Express Mail be reduced \$2 from \$10.75 to \$8.75. The reason given was that the Postal Service wanted to be competitive with the private delivery operations. In the area where the Post Office had a monopoly it was raising rates. In the area where it had to compete, it was lowering rates. Why not give the entrepreneurs an opportunity to compete, as well, in first- and third-class mail?

There should be greater economic use of assets owned by the Postal Service. For example, thousands of Post Office buildings throughout the country occupy very valuable real estate and generally they are no more than two or three stories high. Why not sell or lease out the air rights space above those buildings to entrepreneurs to build 10-, 20-, or 30-story office towers or residential units. The return to the postal administration could be hundreds of millions of dollars.

Local Post Offices in each community are essentially self-contained operating units. Each day the personnel receive bundles of mail which they sort and deliver to the various residences. Give the postal workers the opportunity to set up their own businesses, contracting from the government for this function, but require them to deliver mail twice a day instead of once, and to keep the Post Office open 6 full days a week.

Each community postmaster's facility therefore becomes a franchise operation. Policies and standards would continue to be set by the government. Post Office administration would still be there. Any savings resulting from improved efficiency would be kept by the former employees, now owners of employee stock ownership plans. Employees of the Post Office, many of whom are in dead-end jobs, and I might add generally quite bored, would find themselves as part-owners of a private business in which they share in profits and in the equity. After each employee-owned operation is established, then the government could welcome other bidders for the contract.

Air traffic control is another government function that should be privatized incrementally. Officials revealed to us during our site visitations that it takes 7 years from the time an administrator concludes he needs a new computer component until it arrives in place. By then it is already obsolete because every 6 years a new family of computer components is developed. Most computer equipment used by air traffic control is over 20 years old.

The very nature of our democratic government, with its checks and balances and procedures, the genius of our democracy, does not lend itself to managing a function requiring high technology and subject to a constantly changing marketplace. Such an operation requires an executive with full authority to act decisively.

Air traffic towers should be contracted out or sold to competitive industry. Beginning with towers in smaller communities, as private organizations develop experience and organizational capacity, they should expand into larger airports. Such functions as training of air traffic controllers and the maintenance of control equipment should be contracted out. Over the years, the private sector should be given the opportunity to fully take over this operation.

There are those who argue that the public would not accept air traffic control by profit-oriented business interests because of concern about safety. The argument rings hollow when we recognize that the airlines themselves are owned by private interests. The manufacturing of the airplanes is done privately. The pilots are hired and work for private interests.

In recent years, privatization projects have mushroomed among local governments. A recent survey by Mercer Group of Atlanta revealed that 97 percent of cities and 99 percent of counties that had

tried privatization were pleased with the results. All said they saved money, and 45 percent thought quality improved.

There are many thousands of local and State privatization programs in the United States. At least 30 States are implementing some type of privatization. In Scottsdale, AZ, the fire protection is provided by a private firm, Rural/Metro Co. Its costs are 40 percent below surrounding communities. Further, fire losses dropped by 84 percent since 1985, when they contracted out. That same company now operates in 11 States.

In Pikeville, KY, its waste treatment plant is run by Professional Services Group of Houston, TX, which operates 140 other municipal water treatment plants in 100 cities.

Brown County, WI, has turned its welfare program over to an outside organization. Administrative costs were cut by 50 percent and efficiency and effectiveness improved.

Corrections Corporation of America has more than \$100 million in operational contracts for prisons and detention centers in nine States.

Aspen Systems of Maryland manages public libraries, including those of several government departments.

To conclude, for over a century the worldwide trend had been toward government growth, embodying the nationalization of industry. In the United States, this movement also took the form of subjecting industry to increasing government regulation. It has now been recognized everywhere that neither nationalization nor too much regulation works. In rethinking the proper relationship between government and the private sector, privatization has raised basic economic and management questions.

In effect, we are dealing with the separation of government and business, and the responsibility of each in the management of our Nation. The responsibility of government is governance, looking after the welfare of the people. The responsibility of business is the production of goods and services. This is the heart of the economic and political strength of our Nation.

Thank you for your attention and I would be pleased to respond to any questions you might have.

[The prepared statement of Mr. Linowes follows:]

PREPARED STATEMENT OF DAVID F. LINOWES, PROFESSOR OF POLITICAL ECONOMY AND PUBLIC POLICY, UNIVERSITY OF ILLINOIS, FORMER CHAIRMAN OF THE PRESIDENT'S COMMISSION ON PRIVATIZATION

My name is David F. Linowes, professor of political economy and public policy, University of Illinois and former Chairman of the President's Commission on Privatization. I am pleased to participate in this hearing on privatization opportunities ahead of us.

My testimony today is based largely on the findings and recommendations of the President's Commission on Privatization. Although it has been 7 years since I presented our report to President Reagan and the Congress, it is as relevant and timely today as it was the day I presented it.

All privatization actions involve one or more of several dimensions. First, government should reach out by opening its operations to bring in the creative talents in the private sector. Only those who work for government are allowed to help solve the needs in medical care, education, poverty, and budgetary deficits.

Our Nation is trying to cope with some of the most intractable problems with one hand tied behind its back. The creative talents and ingenuity of those in the private sector are excluded from direct participation unless they quit their jobs and move onto the government payroll. Yet, those entrepreneurs in the free enterprise system are among the Nation's greatest resources. That's not a reflection on those who work



in public institutions. The problem in government institutions is with agency structure and legislative restrictions. Congress has a penchant for micromanaging many agencies.

We can and should use private sector entrepreneurs to achieve more effective government performance. We can do that by contracting out many of the operations.

One-fourth of the government work force performs functions that compete with, and are similar to, work performed by private business. Cutting back this slice of the public bloat would contribute toward concentrating government on governance, where it properly belongs.

A second dimension of privatization is that consumers who require government service should be given a choice, and not be captive to a particular agency—the public school, medical clinic, or housing project—to which they happen to be assigned. Choice injects an environment of competition—the powerful force of the marketplace—in the delivery of social services.

Public school students should be given education vouchers, freeing them to attend the public schools of their choice. Many jurisdictions now have adopted or are in the process of adopting some form of school voucher system. It is worth noting that public schools on average cost \$5,400 per student per year; private schools \$3,900.

Low-income families should be furnished housing vouchers so they can select living accommodations of their choice. Housing of the poor has been a failure. For over 60 years, our Nation has attempted to satisfy the needs of low-income families by furnishing them public housing and some subsidized programs.

We have 1.3 million public housing units. Two-thirds are in substandard condition requiring an outlay of \$25,000 on average per unit, or \$20 billion. Many of these housing projects are overrun by drug pushers and muggers. Others have been demolished after only 12 to 15 years, such as in Newark, NJ; New York City; and St. Louis, MO. These buildings had been constructed with a life expectancy of 40–50 years.

All tenants living in substandard projects should be supplied expeditiously with housing vouchers so they can go into the marketplace and successfully compete for the kind of housing accommodations they require.

We can provide three housing units with vouchers for every housing unit that is provided by building public housing projects; 10 million low-income people need help and they are not getting it. A massive shift in resources toward vouchers would help significantly.

The Medicare program was initiated in the latter part of the 1960's as part of the Johnson administration's agenda for the Great Society. Like Social Security, Medicare was conceived, not as a form of public assistance, but as a form of forced savings to be returned in the form of a benefit in later years.

The Medicare program faces a fiscal crisis. Because of increased consumption and the use of more elaborate technology, medical costs have been increasing at a much faster rate than inflation.

The major cause of accelerating health care costs is the lack of cost-containment incentives. Because consumers do not directly pay the major cost of medical care, their decisions about whether to consume medical care involve virtually no consideration of that cost. Health care providers have little incentive to compete on a price basis. Although there may well be benefits to consumers from the nonprice competition that presumably results, much of health care quality is difficult for consumers to gauge and it is unclear how much real quality competition exists.

Private sector competition, by means of vouchers, in the provision of health care financing (health insurance or HMO's) for the elderly can impart critically needed cost-containment incentives in this market and offer a broader choice of health plan options. The government should act to increase competition and private sector participation in health care by encouraging the use of vouchers and/or capitated payments.

A third dimension of privatization is government should not be in the business of business.

Our Nation should not be a \$200 billion money lender. Government has set up large bureaucratic agencies to make direct loans to home owners, farmers, students, business persons. These same types of loans can be handled by banks who could be contracted to charge the same low costs to the borrowers, the government paying the difference between the charge and the market price.

We have a well-developed banking industry with established administrative procedures, who effectively compete with one another. They are well-qualified to take over this function and administer it. It would handle administrative detail only—not policy. Presently, the default rate for government-administered loans is three times that of private operations.

Producing oil belongs in the private sector. Naval Petroleum Reserves in Elk Hills, CA, and Teapot Dome, WY, should be sold. The original reason for being acquired by President Taft has long passed. We can realize over \$4 billion from the sale of these assets.

The many billions of dollars freed up from these and similar government-owned inappropriate assets could better be invested in reducing the deficit, or in better schools and housing.

In discussing dimensions of privatization, a caveat is necessary. Government should never abdicate responsibility for making policy and monitoring standards that affect the public welfare, even when the operations of a function are turned over to the private sector. Thus, if air traffic control were to be contracted out to private business, the Federal Aviation Administration would always have to be there to continue setting policies and monitoring performance.

There are six reasons a business enterprise in a free market environment produces goods and services in superior quality and quantity to that of a government agency.

1. Government ownership or control involves political influence on the goods and services produced; on the investments in facilities; on the personnel policies. When such decisions are based on political expediency rather than objective facts, the results can be and too often are destructive.

2. A government operation is usually protected by a complete or partial monopoly, and thus misses the drive that competition stimulates. A private firm has to keep its costs down and its output attractive, or it loses its market. This is not true in a government monopoly.

3. Competition gives the consumer a choice, increasing his options, thereby stimulating increased consumption.

4. A government operation which fails to satisfy its customer does not risk going out of business. A private firm does, therefore, it aggressively strives to satisfy the consumer.

5. In government operations consumers' interests are subordinated to the interests of the owner, that is the government agency. In business operations, customers' interests are paramount or the customers leave. Quality and price are key concerns for the private operator.

6. A government agency does not have the drive to keep abreast of the latest technology, to find the latest cost-saving developments, or to innovate. Government operations generally do not have these pressures, nor do they have the funds with which to experiment and research.

It is ironic that government ownership and operation was conceived as a way to give the people better goods and services at lower prices. The argument was that without the cost of profits, competition, and advertising they could outperform the private sector. The fact has been the reverse. Without the competitive stimuli and commercial pressures, government-operated facilities have been less effective as well as more expensive.

In considering change, I am aware the American people do not embrace initiatives that depart too widely from their traditional experiences. Therefore, incremental transfers to the private sector should be provided for. The approach is to build upon gradual successes.

Here are two examples of how privatization can effectively be applied incrementally.

#### POSTAL SERVICE

In the Postal Service, a number of functions are overdue for private sector involvement. Statutes mandating postal monopoly for first and third class mail should be repealed.

When restriction on "urgent" mail was lifted in 1979, we witnessed the dramatic growth of Federal Express, Purolator Courier, DHL and others. The U.S. Postal Service now serves only about 12 percent of the express market.

It is interesting to note that a number of years ago when the Postal Rate Commission recommended increasing first class mail by 3 cents from 22 cents to 25 cents, it also recommended that Express Mail be reduced \$2.00 from \$10.75 to \$8.75. The reason given was that the Postal Service wanted to be competitive in a market dominated by private delivery services. In the area where the Post Office has a monopoly, rates were raised. In the area that the private sector has been permitted to operate, the Post Office reduced the rates in order to compete.

There should be greater economic use of assets owned by the Postal Service. For example, thousands of Post Office buildings throughout the country occupy valuable real estate. Often these buildings are no more than two or three stories high. We

should more aggressively lease out or sell the air rights space above the structures to entrepreneurs for the construction of 10-, 20-, or 30-story office buildings or apartment houses. The return to the postal operations could run into many hundreds of millions of dollars.

Local post offices in each community are essentially self contained operating units. Each day the personnel receive bundles of mail which they sort and deliver to the residences. Give the postal workers an opportunity to set up their own businesses, contracting from the government for this function, but require them to deliver the mail twice a day instead of once; and keep the Post Office open 6 full days a week.

Each community postmaster's facility thereby becomes a franchise operation. Policies and standards would continue to be set by the government. Any savings resulting from improved efficiency would be kept by the former employees, now owners of employee stock ownership plans. Employees of the Post Office, many of whom are in dead-end jobs, would find themselves as part owners of a private business in which they share in the profits and in the equity.

After each employee-owned operation is established, then the government could welcome other bidders for the contract.

#### AIR TRAFFIC CONTROL

Air traffic control is another government function that should be incrementally privatized. Officials revealed to us during our site inspections that it takes 7 years from the time an administrator concludes he needs a computer component until it arrives in place. By then the technology is already obsolete. Most computer equipment used by air traffic control is over 20 years old.

The very nature of our democratic government with its checks and balances and procedures—the genius of our democracy—does not lend itself to managing a function requiring high technology, and subject to a constantly changing marketplace. Such an operation requires an executive with full authority to act decisively.

Air traffic towers should be contracted out or sold to competitive industry. Beginning with towers in smaller communities, as private organizations develop experience and organizational capacity, they should expand into larger airports. Such functions as training of air traffic controllers and the maintenance of control equipment should be contracted out. Over the years, the private sector should be given the opportunity to fully take over this operation.

There are those who argue that the public would not accept air traffic control by profit-oriented business interests because of concern about safety. The argument rings hollow when we recognize that airlines are owned and operated by private industry, and that the plane itself is manufactured by private business. We entrust our lives to the pilot, hired by business, and to airplanes manufactured and operated by private companies.

#### LOCAL GOVERNMENT PRIVATIZATION

In recent years, privatization projects have mushroomed among local governments. A recent survey by Mercer Group of Atlanta revealed that 97 percent of cities and 99 percent of counties that had tried privatization were pleased with results. All said they saved money, and 45 percent thought quality improved.

There are many thousands of local and State privatization programs in the United States. At least 30 States are implementing some type of privatization.

Some examples include:

1. Scottsdale, AZ, fire protection is provided by a private firm, Rural/Metro Co. Its costs are 40 percent below surrounding communities. Further, fire losses dropped by 84 percent since 1985. That same company now operates in 11 States.

2. In Pikeville, KY, its water treatment plant is run by Professional Services Group (PSG) of Houston, TX, which operates 140 other municipal water treatment plants in 100 cities.

3. Brown County, WI, (which includes Green Bay) has turned its welfare program over to an outside organization. Administrative costs were cut 50 percent.

4. Corrections Corporation of America [CCA] has more than \$100 million in operational contracts for prisons and detention centers in nine States.

5. Aspen Systems of Maryland manages public libraries, including those of several government departments.

To conclude, for over a century the worldwide trend had been toward government growth, embodying the nationalization of industry. In the United States this movement also took the form of subjecting industry to increasing government regulation.

It has now been recognized everywhere that neither nationalization nor too much regulation works. In rethinking the proper relationship between government and



the private sector, privatization has raised basic economic and management questions.

In effect, we are dealing with the separation of government and business, and the responsibility of each in the management of our Nation. The responsibility of government is governance, looking after the welfare of a people; the responsibility of business is the production of goods and services. This is the heart of the economic and political strength of our Nation.

Thank you for the opportunity to discuss this most important issue. I shall be pleased to respond to any questions.

Mr. ALLARD [presiding]. I would like to now call on Tony Dale and Tony, I understand that you are a Harkness Fellow and you are on leave as budget manager from the New Zealand Treasury. Welcome, and we would love to hear your testimony.

**STATEMENT OF TONY DALE, HARKNESS FELLOW, THE COMMONWEALTH FUND OF NEW YORK, ON LEAVE AS BUDGET DIRECTOR, NEW ZEALAND TREASURY**

Mr. DALE. Thank you very much.

I would just like to make it clear initially that I am giving this testimony in a personal capacity and the views that I give today do not necessarily represent the views of the New Zealand Treasury.

Although I have a job that is broadly similar to the budget director's job in this country, I am a career civil servant. Those sort of jobs are not political appointments in New Zealand, so I am coming at this from that perspective.

As most of you know, New Zealand is a pretty small country in the bottom of the South Pacific. It has about 3.5 million people and a land mass of around about the size of North Carolina. We have a Westminster British parliamentary system, but with just one house. There is no senate and we have no states, so our political system is significantly simpler than that here.

Just to put it in a little bit of context, GDP in New Zealand is currently around \$90 billion, about \$58 billion (United States), and government expenditure is currently around \$20 billion (United States). So a very small economy in your terms.

However, in the period since 1987, successive New Zealand Governments of both the center left and center right persuasion have sold a considerable number of commercial operations. In New Zealand terms, privatization means selling ownership, usually completely, into private sector hands. Major privatizations in New Zealand have involved financial institutions, including two trading banks, a merchant bank, a rural loan bank and a general insurance company. It has involved the sale of other financial assets including prime rate housing mortgages and farm mortgages.

It has involved the sale of a number of transport operations including a shipping company, an international airline, a railway company and a bus network. A number of infrastructural assets including New Zealand's major telecommunications company and two computer companies. Industrial operations, including a petroleum and petrochemical company, and a part share in a steel company and a number of other trading operations including a hotel chain, the government printer, and forests. Those are the major things that have privatized, there have been others as well.

The scope of privatization in New Zealand partly reflects the wide range of activities that the New Zealand Government has become involved with over the years. However, it also reflects the deliberate effort to reduce the government's involvement in these parts of the economy, its direct involvement through ownership. And also to use the proceeds of these sales to retire public debt.

The other point in here is that privatization in New Zealand has occurred in the context of quite significant macro and micro economic reform. In my written testimony I have outlined the highlights of that.

In the last decade, New Zealand has gone from a highly sheltered, highly protected closed economy to exactly the opposite, a highly open economy with very little protection for any industries or farming producers and low inflation, relatively high growth rates forecast to be around 6 percent real this year from a last two-decade average of zero to 2 percent growth, and inflation of less than 2 percent.

We have just turned our fiscal deficit into a fiscal surplus for the first time in a couple of decades and we are now starting to repay public debt. So a wide body of economic reform underlies the New Zealand experience.

As part of that economic reform the Labour Government, which was elected in 1984, a center left government, undertook the economic reforms, and looked at the public sector. The reason for that was that in 1984 government expenditures, including transfers, equaled about 40 percent of GDP. So if you are worried about improving economic performance for the country as a whole, you needed to think about improving the economic efficiency of the public sector.

There are sort of three main strands to public sector reform in New Zealand. The first was the process of corporatization, which was taking the trading activities of government, turning them into stand-alone commercial companies, established under commercial law in New Zealand, under company law, with private sector boards of directors and private sector management, with a single, clear, commercial objective. That was to be as profitable as any other comparable private sector business.

The major difference between them and the private sector was that the government were their shareholders. But they had to pay tax, they had to pay dividends, and they had to compete in the marketplace. A large part of that process of corporatization was actually about creating a commercial environment, a competitive commercial environment in which they had to operate.

So in most cases, during that corporatization process, although they were still owned by the government, they had no protection from the government in terms of monopolies. They had to compete in the marketplace. Not in all cases, but in most.

That was the corporatization process and I am happy to answer questions on that in more detail later.

Although the corporatization process resulted in enormous efficiency gains, and they were quite startling, there are a number of reasons why owning a state-owned enterprise, a government company, is still regarded as a suboptimal form in New Zealand. The first is the opportunity cost. They tie up money by way of capital

investment in those organizations that could otherwise be used to repay debt.

Secondly, they are not subject to the ultimate discipline of the market. Although a state-owned enterprise has to trade in the debt market, has to get its debt financing from the private sector debt market, there is still a perception that there is some form of implicit of government guarantee lying behind that debt and that undermines slightly that debt market competition.

Further, as a state-owned enterprise's shares are not publicly traded, and they are held by the government, an SOE is not subject to the ultimate efficiency discipline of the equity market. Another reason why that form is suboptimal is that governments are generally unwilling and often unable to invest the amounts of capital needed to develop large commercial businesses, particularly high tech businesses like computer companies, telecoms, and so forth. In short, government usually has other things that they wish to do with their money than invest in these sort of activities.

Finally, the ownership of commercial ventures exposes governments to substantial fiscal risk. This is something the New Zealand Governments have had to manage. For example, in 1990 the government of the day had to fund a substantial rescue package to support the government-owned trading bank, the Bank of New Zealand. That rescue package was about  $\frac{1}{25}$ th of the government's expenditure that year, so a very substantial amount.

For these reasons, successive New Zealand Governments have privatized commercial activities that they considered that they did not need to own. Now each sale has been identified on a case-by-case basis and the broad principles that have guided this case-by-case evaluation have been firstly that a sale will only be made if taxpayers receive more from the sale than they would through continued ownership. Basically in every case, that criteria has been met reasonably comfortably. Secondly, that the sale must make a positive contribution to the government's economic and social policies, that it must be consistent with the government's other political objectives. Sales of companies in New Zealand have been conducted through a whole series of means, including an open tender process, open bid process, sometimes share floats, and occasionally management buyouts. Management buyouts have been used relatively infrequently because typically those offers are much lower than other bid offers.

There are, I think, a few lessons that can be drawn from New Zealand's experience. The first is the value of a clear set of privatization objectives. In the New Zealand case, these objectives related to firstly, improving overall economic performance. Private sector-owned commercial operations are subject to much greater market discipline and have better sources of capital when they have private owners. So improving overall economic performance is a key driver behind privatization.

The second clear objective was, in New Zealand's case, to obtain the maximum sale value for each asset, even if this meant selling to offshore owners, which happened in many cases. And even if this meant selling just to one owner, rather than a share float or spreading ownership across a wide group in the public, as has happened in many other countries.



Another clear objective of the New Zealand privatization process was to only sell when the proceeds of sale are greater than the proceeds from continued ownership, and that was a key decision criteria.

The fourth key objective of New Zealand's privatization was to use the proceeds to repay debt, not to fund additional expenditure. In fact, the proceeds of privatization of what we call asset sales are not included in the calculation of the deficit in New Zealand as part of that reason.

The second lesson that perhaps can be drawn from the New Zealand experience—

MR. SMITH OF MICHIGAN [presiding]. Excuse me, Mr. Dale. Excuse me for interrupting, but I do want to leave time for questions, also, so if you can somehow wrap it up. Thank you.

MR. DALE. The second reason really relates to the regulatory system and the importance of getting the regulatory system right. That has been a big issue in New Zealand, making sure that these privatized operations run in a competitive environment, removing monopolies, and getting the right regulatory environment.

For that reason, the New Zealand Post, which is the post office commercial activity, has not been privatized because they have a letter monopoly, standard letter monopoly, and until that issue is adequately addressed, that has not been privatized. Similarly, the Airways Corporation, which runs the air traffic control system, essentially has a natural monopoly and has not been privatized, either.

Also, there are a number of lessons about how to privatize that we have learned, that it takes quite a long time, and that it is much easier to sell through a tender process than a public float process, and to sell to one owner.

Thank you very much.

[The prepared statement of Mr. Dale follows:]

PREPARED STATEMENT OF TONY DALE, HARKNESS FELLOW, THE COMMONWEALTH FUND OF NEW YORK, ON LEAVE AS BUDGET DIRECTOR, NEW ZEALAND TREASURY

MR. Chairman, thank you for the opportunity to take part in this panel on privatization.

#### INTRODUCTION

New Zealand is a small country in the South Pacific. It has around 3.5 million people and a land mass of around 267,000 square kilometers. It has a Westminster (British) parliamentary system with one house and no states.

GDP is around NZ\$90 billion (around US\$58 billion) and government expenditure is around NZ\$31 billion (around US\$20 billion).

In the period since 1987, successive New Zealand Governments have sold a considerable number of commercial operations. Major privatizations have involved:

Financial institutions, including two trading banks, a merchant bank, a rural loan bank, and a general insurance company;

Financial assets, including prime rate housing mortgages, and farm mortgages;

Transport operations, including a shipping company, an international airline, a railway company, and a bus network;

Infrastructural assets, including New Zealand's major telecommunications company and two computer companies;

Industrial operations, including a petroleum/petrochemical company and a part share in a steel company; and

Other trading operations, including a hotel chain, the government printer, and forests.

The scope of operations privatized is partly a reflection of the wide range of activities the New Zealand Government had become involved with over the years.

However, it also reflects a deliberate effort to reduce the government's involvement in these parts of the economy and to use the proceeds to retire public debt. Before discussing a few lessons from New Zealand's experiences, I will first briefly summarize two antecedents to privatization:

Economic reform; and  
 "Corporatization" of trading activities.

#### NEW ZEALAND'S ECONOMIC REFORMS

The origins of New Zealand's privatization policy lie in the substantial macro and microeconomic reform that has occurred over the last decade.

In 1984 the incoming Labour Government inherited a closed, highly regulated economy in substantial difficulty. The degree of this difficulty is most graphically illustrated by the state of the financial markets. In the week leading up to the general election the government had been forced to close the then-fixed rate foreign-exchange market because the central bank could not support the New Zealand dollar.

There was also a significant financial deficit, growing levels of public debt, large current account deficits, high underlying inflationary pressures, and a history of slow economic growth.

The economy was characterized by comprehensive controls on the financial sector, extensive subsidies for farmers and exporters, and a highly sheltered private sector.

The government set about putting in place a set of economic reforms designed to create an open, externally focused, internationally competitive economy. This involved reform of almost every sector of the economy.

Some of the major economic reforms initiated by Labour and National Governments over the last decade include:

Removal of subsidies to farming and other industry, and phasing down (and in some cases out) of tariffs and other forms of border protection;

Deregulation of all major sectors including the banking and finance, transport, energy, telecommunications, broadcasting sectors;

Removal of controls on international capital movements;

Floating of the exchange rate;

The imposition of a tight monetary policy regime, including creating independence for the central bank and giving it a single objective—to control inflation;

Reform of the personal and company tax systems, including a shift toward indirect tax and broad-base, low-rate company tax strategy;

Reform of labour market legislation; and

Control of government expenditure, and reduction of the deficit and public debt.

Microeconomic reform has occurred in most sectors of the economy, including the health, education, and welfare sectors which are funded primarily by government, and local government.

The results of this reform, together with reforms to the public sector (which are discussed below) are now beginning to show through in good economic performance. Currently:

Economic growth [GDP] is running around 5–6 percent and is expected to settle at around 4–5 percent per annum;

Inflation is around 1.5 percent per annum and forecast to stay at levels less than 2 percent;

The fiscal position is in surplus (on both a cash and accrual basis) and forecast to reach 7 percent of GDP by 1997/98;

Public debt is declining and projected to be around 17.5 percent of GDP by 30 June 1998 (down from a peak of around 60 percent of GDP in the late 1980's); and

Employment levels are at their highest in New Zealand history and unemployment has fallen to around 7.5 percent (from a high of around 11 percent)

#### REFORM OF GOVERNMENT TRADING ACTIVITIES: CORPORATIZATION

In 1984, government expenditure accounted for around 40 percent of GDP. This meant that an economically inefficient public sector would drag down the performance of the economy as a whole.

The Labour Government thus set about reforming the public sector. This took several forms:

Reform of the trading activities of government (corporatization);

Reform of the "core" activities of government (public sector management reform); and

Reform of specific sectors (such as health, education, welfare).

The corporatization reform is of most relevance to these hearings.

The State-Owned Enterprises Act of 1986 established the legislative framework for establishing trading activities as government owned companies—State Owned Enterprises [SOE's]. The objectives of this policy were that the SOE's should:

- Have clear, commercial objectives;
- Operate in a competitively neutral environment;
- Have greater managerial flexibility and authority over key decisions;
- Be subject to greater performance monitoring; and
- Be funded by explicit grants to cover noncommercial objectives.

In practice this meant establishing SOE's under private sector company legislation, with private sector Boards of Directors and Government Ministers as shareholders. SOE's were required to operate as profitably as comparable private sector companies, borrow from the financial markets and pay dividends and taxes at commercial rates.

They operate outside the government's normal budgetary and reporting processes but are required to agree to a 5-year business plan with their shareholders each year and are subject to an extensive monitoring and reporting regime.

Regulatory reform proceeded in parallel with the SOE reform so that market competition was maximized.

In practice little explicit subsidization of noncommercial activities has taken place.

#### PRIVATIZATION

Although the corporatization process resulted in enormous efficiency gains, there are a number of reasons why an SOE is still a suboptimal form:

They tie up money that could be used to repay debt;

They are not subject to the ultimate discipline of the market. Although SOE's trade in the debt market, there is a perception that some form of implicit of government guarantee exists. Further, as SOE shares are not publicly traded an SOE is not subject to the ultimate efficiency discipline of the equity market;

Governments are generally unwilling (or unable) to invest the amounts of capital needed by developing businesses, particularly high-tech businesses. Governments have other things to do with their money; and

Ownership of commercial ventures exposes governments to substantial fiscal risk. For example, in 1990 the government had to fund a substantial rescue package to save the government-owned Bank of New Zealand.

For these reasons successive New Zealand Governments have privatized commercial activities that they considered the government did not need to own.

Each sale has been identified on a case-by-case basis. The broad principles guiding this evaluation have been:

That a sale will only be made if taxpayers receive more from the sale than they would through continued ownership; and

The sale must make a positive contribution to the government's economic and social policies.

Sales have been conducted through a variety of means including open tender, share float, and management buyout. The latter has been used infrequently because the price offered has generally been too low.

#### LESSONS FROM THE NEW ZEALAND EXPERIENCE

There are a number of lessons that can be drawn from the New Zealand experience.

The first is the value of a clear set of privatization objectives. In the New Zealand case these related to:

Improving overall economic performance: commercial operations are subject to greater market discipline and have better sources of capital when they have private sector owners;

Obtaining the maximum sale value for each asset, even if this means selling to offshore owners;

Only selling when the proceeds are greater than the proceeds from continued ownership; and

Using the proceeds to repay debt, not fund additional expenditure.

The second relates to the regulatory system. In the New Zealand case it has been a prerequisite to get that right before privatization occurs. Although a greater price might be obtained by selling an operation with a statutory monopoly, this would be at the expense of economic efficiency. We have endeavored to ensure maximum contestability in the marketplace.

For this reason the statutory monopolies enjoyed by Air New Zealand and Telecom were removed prior to sale. For the same reasons NZ Post (the postal serv-



ice) which for social reasons enjoys a statutory monopoly on standard letters has not been a candidate for privatization under those conditions. Similarly, Airways Corporation (which runs the air traffic control system) has a natural monopoly and has not been considered for privatization.

The third is a series of lessons about how to privatize. Over the years we have learned that:

It is much easier to privatize from a corporate form rather than from within a departmental structure;

It is more efficient and effective to sell a business as a whole through an open tender process than through the share market;

Generally it is better to do any major business restructuring before putting the assets up for sale; and

The sale process can take a year or more.

#### CONCLUSION

This ends my formal testimony.

Mr. SMITH OF MICHIGAN. Mr. Dale, thank you very much for taking your time to be here. We are delighted to have that good information. I would like to mention that your testimony, in total, will be part of the record and be made available to all members of the committee.

Mr. Robert Poole, who is president of the Reason Foundation, started his work on privatization almost before anybody else, back in the 1970's, and has been advisor to two administrations in this area and the economy of government operations. Mr. Poole.

#### STATEMENT OF ROBERT W. POOLE, JR., PRESIDENT, REASON FOUNDATION, LOS ANGELES, CA

Mr. POOLE. Thank you very much, Mr. Chairman.

The Reason Foundation, as you say, has been researching privatization for 17 years now. Now that this country seems to be poised to embark on a serious national privatization effort, I think it is important to see what we can learn from the efforts of not only New Zealand but of the hundred other countries which have been privatizing over the past decade.

I want to limit myself to discussing two forms of privatization today, the sale of state-owned assets and enterprises, and the use of the private sector for infrastructure. Around the world, as your chart shows, over \$450 billion worth of state-owned enterprises have been privatized during the past decade.

Critics sometimes say this is selling the family silver, intending to deride it. But if the proceeds are used to pay off debt, as was done in New Zealand, then the benefits are not just one time proceeds; a smaller national debt means lower interest payments indefinitely. Privatized firms will no longer get subsidies, so that is a reduction of future expenditures. And they will start paying Federal income taxes. So asset sales can be a sound long-term, not just one-shot, deficit reduction policy.

Table 1 in my printed testimony, which I believe you have, is a first tentative list of saleable Federal enterprises that we have identified. I want to discuss just a few of these.

The first four are all enterprises dealing with electricity. Last year around the world, some \$11 billion worth of state-owned electricity firms were privatized. This is no longer difficult or controversial in most countries. Besides the fiscal benefits of privatization, there is another good reason to privatize electricity enterprises, and that is their own survival.

Electricity deregulation is coming fast, first in California, and bureaucratic state-owned electricity systems are going to have a very tough time coping with a deregulated environment. The best thing that Congress could do for Federal electricity operations is to set them free, letting them raise capital in the marketplace, and letting them bring in more entrepreneurial management that can cope with the new world that is about to come.

This country cannot afford another WPPS debacle, where managers get in over their head and do not really know what to do. I understand the concerns that employees and ratepayers will have over privatization. Other countries have faced exactly the same problem. The answer that works best is stock ownership. It has become standard practice to set aside a portion of the shares for employees and managers, to give them a real stake in changing the corporate culture to make the company successful.

In England, when they privatized all of their utilities—gas, water, electricity—a standard practice was giving the ratepayers the opportunity to buy shares at a discount, even on their monthly utility bills. You just buy shares over time. That way, even if the rates go up due to privatization, customers can benefit when the value of their shares goes up and when they get dividend payments every year.

Another item on our list is the Postal Service—10 years ago, people really did not take this idea seriously, but since then believe it or not Sweden and the Netherlands have privatized their postal services. Argentina and Malaysia are planning to do so, Britain and Canada are seriously studying the idea.

As with electricity, this may be a matter of survival for the Postal Service. As Professor Linowes pointed out, our Postal Service keeps losing market share because it cannot compete with overnight services, fax machines, and e-mail. The best thing Congress could do, again, would be to set it free in two different ways.

First, let it compete with all other forms of delivery, but you have to let others compete with it, as well, in its current monopoly areas. Second, let the Postal Service go to the capital markets to buy its assets from the government, turning itself into an entrepreneurial company, as Sweden Post has done. Here again, stock ownership for employees and managers could make a real difference in turning the enterprise around.

Also on the list are several high-tech enterprises like air traffic control, the Weather Service, the Geological Service, and some of NASA's aeronautical labs. In each of these cases, there are valuable services being produced by dedicated people, but they are hamstrung by cumbersome government procurement practices, personnel practices, uncertain budgets, inability to modernize rapidly, and the lack of market pricing for their services.

Each one of these should be turned into some form of commercial enterprise, either nonprofit or for-profit, as the case may be, but outside the Federal Government although the government may still be a customer, an important customer, of some of these entities.

Here again, we can learn from our friends overseas—10 countries have now corporatized air traffic control in the last decade, including Britain and Germany. Britain has begun to privatize some of its government R&D facilities by worker/management buyouts.

Amtrak, you will see, is also on the list, although I am not very optimistic in this case. I happen to be a rail fan and I hope Amtrak can be salvaged, but to get anyone interested in buying it, there will need to be radical reform of its labor practices to be able to operate like a normal business, and also broad authority for Amtrak to be able to discontinue money-losing routes, just as Congress did when Conrail was privatized, which made a big difference in Conrail's success.

Table 2 of my written testimony, again which you have, is a second list. This is a list of Federal assets, as opposed to enterprises, that could be sold. I want to mention just two in the brief time I have here.

When I say commodity lands, I am referring to commercial timber lands and grazing lands. Putting these lands into private ownership would actually enhance environmental values. Owners of commercial forests do not build roads that cost far more than the timber is worth, the way the Forest Service does, and they do not clear-cut huge tracts of land and leave them barren to erode onto neighbors' property. Private owners protect the value of their asset for the long run. Congress can also attach deed restrictions here, guaranteeing rights of access for backpackers, for hunters, for fishermen, and other multiple users to preserve these important public goals.

I also want to mention broadcast frequencies, which is another asset. Spectrum is becoming the key economic resource on which the information/telecommunications revolution depends, yet government ownership and allocation of this resource represents central planning at its very worst.

A single UHF channel in Los Angeles that is worth only a few million dollars in its current use could be worth as much as \$1 billion if that channel were carved up into cellular telephone frequencies, which is what the market would do if it were privately owned. Why should government be making arbitrary decisions about how to use which piece of spectrum?

Current users should be allowed to buy true ownership rights and the right to resell frequencies to higher and better uses, as determined by the marketplace. The FCC should simply be the policeman, preventing interference from one frequency to another, not the central planner.

Now let me turn to the other type of privatization, just briefly, and that is infrastructure franchises. Here again, much of the world is way ahead of the United States. Countries in Europe, Asia, and Latin America are all selling airports and water systems and granting long-term franchises to private firms to build new toll roads, new airports, new waste disposal systems.

They are doing this for several reasons. First of all, these are not core governmental functions and private enterprise is generally better at building and running these things than government is. Second, governments are short of funds to invest in infrastructure and investors are willing and able to invest their own money if government lets them earn a competitive return.

Third, the private sector can generally build new infrastructure faster and cheaper than government can. Fourth, shifting infrastructure development to the private sector shifts much of the risk



as well. How many more Denver airports can this country afford? The risk of that kind of development belongs in the private sector, not in government hands.

And finally, privatizing infrastructure will mean putting all of these valuable facilities onto the tax rolls for local taxes, State taxes, and Federal taxes.

In this country, Congress, the Bush administration, and the Clinton administration have all endorsed the idea of private investment in the country's infrastructure. But these several Federal initiatives, like ISTEA, have had almost zero effect on actually generating investment. Why?

The problem is Federal law has not really come to grips with what it means to have private enterprise doing these things. Federal law, in effect, encourages municipal socialism for several reasons. Tax law says that if you are a government-owned airport or utility, you do not pay taxes on your profits and the interest on your bonds is tax-exempt, meaning your interest costs are lower. If the identical facility is investor-owned, both the profits and the bond interest are taxed.

Second, Federal grant policy exerts a kind of a transfer tax on the sale of one of these enterprises. If any Federal grants have gone into it, if you try to privatize it, you have to pay back part of the Federal grants. Again, the private sector gets the message: "Government does not want us to do this."

Third, regulatory policy often exempts government-owned facilities such as a wastewater treatment plant from various regulations like RCRA, but subjects the identical facility to industrial-strength regulation if it is privately owned. So again, the private sector gets the message clearly. It gets the message of what the law says, rather than what the rhetoric says. When Bush and Clinton and Congress say they want private sector infrastructure, the law says we encourage government infrastructure. We assume government infrastructure, municipal socialism.

Congress could change all this by changing the tax laws, regulatory policies, and grant rules so that all public purpose infrastructure is treated the same way, regardless of who owns it, whether it is investor-owned or government-owned. Just making all new issues of infrastructure bonds taxable, the interest on them taxable, would generate \$24 billion a year by the time this was fully transitioned into place—\$24 billion a year, a nice sum for deficit reduction.

Now let me wrap up by trying to sum up the implications. In my written testimony, again, in Table 3 is a summary of the proceeds from asset and enterprise sales. Just the ones that we have listed would total \$382 billion worth of sales proceeds. And if, as we recommend, that were used to pay down the national debt, the way New Zealand does, there would be annual interest savings of about \$29 billion a year. There would also be reduced annual subsidies, with the government no longer running these things, of \$11 billion. Increased Federal tax revenues of \$13 billion.

That adds up to \$53 billion a year of permanent annual ongoing deficit reduction. In addition, if you ended the tax exemption for interest on infrastructure bonds, that would be another \$24 billion a year, totaling \$77 billion a year permanent deficit reduction.

I think that is a big enough sum that it is worth putting some effort into, but unfortunately I think it is not too likely to happen if each of these measures has to be fought for one by one. It is a problem like that of surplus military bases. Everybody knows it should be done, but each individual one has a lot of defenders and people do not want to vote to close it.

So I think Congressman Arme's breakthrough solution of a Base Closing Commission that took a whole package each year and required an up or down vote on the whole thing suggests a good model here for fostering privatization. Either a separate privatization commission or the Spending Reduction Commission proposed by Senator Connie Mack and Congressman Dan Miller of this committee could do this kind of thing, set an annual target for privatization proceeds, put a whole package of recommendations together, and have a single up or down vote on the package.

I think that is the most likely way to accomplish the kind of large potential that privatization really offers to the United States.

I am about out of time, so I would welcome questions on anything that I have addressed today. Thank you.

[The prepared statement of Mr. Poole follows:]

PREPARED STATEMENT OF ROBERT W. POOLE, JR., PRESIDENT, REASON FOUNDATION,  
LOS ANGELES, CA

My name is Robert W. Poole, Jr. I am president of the Reason Foundation, a non-profit public policy research institute based in Los Angeles. For 17 years we have been researching privatization on a worldwide basis. I have done research on this subject under the auspices of the U.S. Agency for International Development and the World Bank, and I have advised, among others, the President's Commission on Privatization, the White House Office of Policy Development, the U.S. Department of Transportation, and in the current administration both the National Economic Council and the National Performance Review.

First of all, I want to clarify what I mean by the term "privatization." The word has become an umbrella term to include a number of different ways in which functions and responsibilities can be shifted, in whole or in part, from government to the private sector. The four most common forms of privatization are asset sales, infrastructure partnerships, contracting out (outsourcing), and vouchers. All four have been used successfully by the Federal Government, and each has its place in the "reinventing government" toolbox. In my testimony, I will limit my comments to just the first of these two, asset divestiture and infrastructure partnerships.

#### ASSET DIVESTITURE

Divestiture of state-owned assets and enterprises is the most common form of privatization worldwide. Some 100 countries have organized programs to divest assets, and over the past decade the sale of state-owned assets and enterprises has generated over \$445 billion. This total reflects only the proceeds from public share offerings and the sale of assets or enterprises to corporate buyers. It excludes two other forms of divestiture which may also have their place.

Some assets and enterprises may have zero or negative net worth while costing the government significantly in annual operating subsidies (e.g., Amtrak). It may make sense in such cases for the government to simply give the enterprise to its workers and managers, or to its users, along with the future responsibility to operate it without further subsidy. While generating no sales revenue, this type of transaction can reduce the Federal budget deficit by eliminating various annual subsidies.

A second type of giveaway has been used mostly in former Communist countries: voucher privatization. In these cases the government gives citizens vouchers which they can use to purchase the shares in various government enterprises. The purpose is to spread ownership widely and create sufficient investor share-ownership to permit the creation of stock markets, mutual funds, and other aspects of private capital markets. This form of divestiture probably has very little application in the United States.

The most common objection to selling government assets is that this would be "selling the family silver" in order to make ends meet. In other words, it is argued that it is shortsighted to focus on the one-time gains from such sales, when in theory the government could be better off if it operated these enterprises more efficiently itself and kept the profits. This argument is not borne out by experience.

First of all, most government enterprises make losses, not profits. If it were easy for government to run them efficiently and profitably, why aren't most of them churning out profits for the Treasury today? The reality is that over the years these enterprises have been saddled with all kinds of directives and controls that constrain them from operating as true businesses. Our counterparts in England, France, Italy, Germany, Australia, New Zealand, and elsewhere have all found that it is much easier to make these enterprises efficient and profitable by privatizing them by attempting to reform them within the government.

In fact, we find that the financial benefits of divesting state-owned enterprises are not limited to a one-time windfall from the sale. That is just part of the benefit—and at \$445 billion worldwide—it is clearly no small part. The second benefit is the permanent, ongoing savings from the elimination of annual (or periodic) operating and capital subsidies for these enterprises. A third financial benefit is the new streams of tax revenue produced by these now-private enterprises. These include Federal corporate income taxes, State corporate income taxes, and local property taxes. Finally, if the proceeds from asset sales are used to reduce the national debt (by reducing the need to roll over Treasury bonds that come due), there will be significant annual savings in interest costs.

#### SALE OF FEDERAL ENTERPRISES

Table 1 lists some of Federal enterprises which are potential candidates for privatization as going concerns. While a detailed discussion of each one is beyond the scope of this testimony, a few comments about groups of these enterprises are certainly in order.

##### *Electricity*

The first four items in the table are all Federal energy utility systems. The Federal Government is the Nation's largest producer and distributor of electric power, a role that may once have been justified in the name of economic development but which can no longer be considered governmental in nature. Worldwide, some \$11 billion of electric utility systems were privatized in 1994, the second largest category after telecommunications systems. No arcane knowledge is needed to privatize a hydropower dam, a power marketing agency, a military base utility system, or a municipal electric utility. Investment bankers and accounting firms have been analyzing and carrying out such transactions around the globe for the past 10 years. A wealth of expertise is available on how to structure such deals, and how to deal with the inevitable political concerns.

One of these concerns is possible rate increases for the users of these systems. The traditional "public power" argument is that public (i.e., government) ownership means lower-cost electricity. In fact, there is no empirical evidence that the inherent costs of government-owned electric power systems are any lower or their efficiency any greater. The reasons why comparisons sometimes show lower rates for users of public power are purely the result of artificial advantages given to such systems by government intervention: specifically, exemption from various local, State, and Federal taxation; tax-exemption of bonds used to finance such systems; and in some cases access to below-market borrowing from the Federal Treasury. In addition, government-owned retail electricity providers are arbitrarily given first preference for purchasing this artificially cheaper electricity. All of these interventions should be abolished, so that the choice between government- or investor-ownership can be decided case-by-case, on the merits, rather than on the basis of government biasing the case in favor of socialized enterprise.

Since a privatized TVA or PMA or a Corps of Engineers dam will lack these artificial advantages, it is possible that the rates it will have to charge post-privatization will be higher than those that it charges today. Needless to say, the customers of those facilities will not be happy about the possibility of higher rates and may therefore oppose the privatization.

Several points need to be made in this regard. First, with electricity deregulation fast approaching, it may well be a matter of survival for government-owned electric utilities to develop a truly commercial, entrepreneurial corporate culture. And the best way to do this is to become a true commercial enterprise, answerable to shareholders who can kick out stodgy management that is not up to the task of coping with deregulation. Ratepayers whose utility management makes bad decisions



(think back to the WSPPS debacle) will ultimately face even higher rates in the wake of bankruptcy proceedings.

Secondly, the extent of rate increases may not be as great as ratepayers fear. There are strong pressures for efficiency within investor-owned utilities, especially as the environment becomes more competitive. Efficiencies in operations and maintenance, capital investment programs, and financing can offset much of the difference made by government-run systems' lack of having to pay taxes.

Third, somewhat higher electricity rates in regions where rates have been below market are objectively a good thing. The Pacific Northwest, in particular, has shown the least degree of energy conservation, because the artificially low rates provide less incentive for people to insulate, buy energy-efficient appliances, et cetera. It would be good, as a matter of national environmental policy, for all parts of the country to pay market prices for electricity, and we expect some environmental groups will support privatization for this reason.

Finally, privatization programs can be designed to include share ownership for electricity ratepayers. In the United Kingdom's privatizations of utilities—telecoms, gas, water, and electricity—the government set aside a portion of the shares in the new utility firms specifically for the ratepayers, at a discount from the initial offering price. Special offers were made so that ratepayers could purchase the shares over a period of time, making payments along with their monthly utility bills. Encouraging ratepayers to become shareholders will enable them to share in the new companies' profits, via dividends—thereby helping to offset any adverse impact of higher electricity rates.

### *Postal Service*

One of the most valuable Federal enterprises is the U.S. Postal Service. Its value stems in part from its ability to provide a highly valued nationwide service and in part from its extensive real estate holdings. As with many of the other enterprises that should be privatized, the most important reason to privatize the Postal Service is not to raise money but to improve the organization's ability to survive and thrive.

There is no need to belabor the obvious. Having already lost first the majority of its package-delivery market and then the overnight high-priority market, USPS is now losing an increasing fraction of its first-class market to the fax machine and e-mail. Yet two factors prevent USPS from responding to these challenges like a commercial enterprise. First, its monopoly status enables it to subsidize new services with profits from monopoly functions, quite correctly leading commercial providers of such services to object mightily to any proposed new ventures by USPS. Until USPS gives up its statutory monopoly, it will not be freed to compete, as it must do to survive. Secondly, USPS's corporate culture is still that of its predecessor government agency. Lacking shareholders that can hold management accountable for truly commercial performance—and constrained by its mountain of procedural rules and redtape—USPS is simply unable to operate like a real business.

Privatizing and deregulating USPS is therefore essential for its survival. The world is already moving in this direction. Sweden was the first country to privatize and deregulate its postal service, in the late 1980's. Sweden Post, now facing two competitors, is today efficient and profitable. The Netherlands last year sold part ownership in its postal service via share offering, and Netherlands Post now competes outside its borders for international air mail. Argentina has announced that its postal system will be privatized this year. Malaysia has announced plans to do likewise, and both Britain and Canada also have plans on the drawing board to do so.

The major source of resistance to postal privatization is the postal employees and their unions. The best way to reassure them that privatization is truly in their interest is to give them partial ownership in the privatized firm. Earmarking for workers and managers of a meaningful fraction (e.g. 10 percent or more) of the shares in a firm being privatized has become routine around the world, especially for large firms and especially for those which are labor-intensive. Turning workers and managers into shareholders is one of the best-known ways to change the corporate culture of a bureaucratic enterprise, giving every individual a tangible stake in its success as a profitable private enterprise. Privatizing USPS could involve the creation of the world's largest employee stock ownership plan [ESOP].

Other concerns such as whether there should be uniform nationwide pricing are actually small details. As with airline service to small, rural communities following airline deregulation, the least-bad approach—if some form of protection for rural areas is judged essential—is a targeted subsidy program for the first 5 or 10 years. The cost would be minimal in comparison with the huge benefits of more user-friendly nationwide postal service.

### *Air Traffic Control and GPS*

For these two high-tech functions, the imperative to privatize is so that users can realize the full potential of these vital 24-hour-a-day services.

As I have indicated in separate testimony to the House Aviation Subcommittee, there is near-consensus within the aviation community that the problems of governmental personnel, procurement, and budgeting systems fatally hamstring the performance of the Nation's Air Traffic Control [ATC] System. It cannot retain sufficient highly experienced controllers in the most demanding locations due to civil service. It cannot procure state-of-the-art computers and electronic systems, because by the time its procurement process is completed, the systems have already become obsolete. And it cannot rationally plan and implement a modernization program on a year-by-year pay-as-you-go basis.

The answer, as 10 other countries have already found, is to convert ATC into a separate user-funded corporation, independent of governmental personnel, procurement, and budgetary systems. It should also recruit its board and senior management from private industry, use generally accepted accounting principles, and borrow only from the private capital markets, not the Treasury.

Because the ATC corporation will continue to operate as a monopoly, we recommend that it become a user-owned not-for-profit corporation much like ARINC (Aeronautical Radio Inc.). A user co-op avoids the need for conventional detailed public utility regulation, as long as its charter provides adequate protection for smaller categories of users. Rates and charges should still be appealable to the Secretary of Transportation.

Much the same analysis can be applied prospectively to the Global Positioning System, the complex of satellites which provide real-time position-locating worldwide. Developed originally for defense purposes, the system has now been opened to civilian users. Full use of GPS's tremendous capabilities over the next several decades promises huge benefits—to aviation, ocean shipping, trucking companies, fleet managers, individual drivers (navigation systems), hunters, backpackers, et cetera. But continued DOD operation and management of the system is likely to lead to underexploitation of the full range of GPS's potential.

Hence, there is a good case for devising a form of privatization under which DOD's defense needs can continue to be met while the system's full commercial potential is developed. A federally chartered corporation is probably the answer, whether a government corporation, a user co-op, or a regulated investor-owned firm. The pros and cons of these alternatives need to be studied carefully.

### *U.S. Enrichment Corporation*

In 1993 the government's uranium reactor-fuel production activities were removed from the Energy Department and reorganized as a government corporation, with privatization contemplated as a future possibility. The corporation's book value (net worth) is now \$1.4 billion and it is turning a profit. It should be streamlined and prepared for sale to investors.

### *Research Agencies*

The next three items on the list are all involved in science-based activities for which commercial markets exist, and in which the agency's ability to operate commercially is often restricted by the constraints of being a government agency.

Both the National Weather Service and the U.S. Geological Survey generate information products whose commercial value is potentially quite large. But their status as government agencies has required them to give away or sell for token amounts much of this valuable information. (Ironically, many of the buyers repackage and enhance this windfall of information and resell it for significantly more money.)

Both NWS and USGS are plagued by budgetary constraints, making it difficult for them to afford state-of-the-art computer systems that are critical to their success in processing the large volumes of information inherent in their work. As commercialized entities, they would be free to borrow in the capital markets to modernize their equipment, demonstrating the soundness of these investments in terms of future sales of enhanced information products.

NASA's aeronautical laboratories (Ames, Dryden, Langley, and Lewis) are in a slightly different situation. The market for their aeronautical research and development is limited principally to the producers of aircraft and aircraft engines, along with the military. The labs' findings are provided at no charge to those firms and DOD. Hence, taxpayer support for these labs amounts to a subsidy to a specific industry and to DOD. Privatizing these labs would be a way to end this industry-specific subsidy, requiring those firms to purchase this valuable information and incorporate the cost into the ultimate prices of their products. DOD would become responsible for funding that portion of these labs' work that it finds valuable.

Worker-management buyouts would be one form of privatization suitable for NWS, USGS, and the NASA labs. Tradeoffs between for-profit and not-for-profit organization should be analyzed to determine which form of organization would be most compatible with the long-term viability of each entity.

#### *Amtrak*

Though frequently appearing on lists of privatization candidates, Amtrak will be difficult to privatize in anything like its current form. Were the company to be put up for sale, as is (and with all current laws and provisions unchanged), it is highly doubtful that a single serious bid would be received.

As is well known, Amtrak covers neither its operating nor its capital costs from its fares. Even the Northeast Corridor, where Amtrak enjoys its heaviest patronage, is a money-losing proposition.

The only way in which viable bids might be received for Amtrak is if Congress enacted major changes in the law that would permit dramatic reductions in Amtrak's costs. Such measures might include repeal of the Federal Employers' Liability Act (at least as it applies to Amtrak), amending the Railway Labor Act to reduce severance pay from 6 years to 6 months, repealing statutory requirements mandating various types and levels of Amtrak service so as to permit it to discontinue specific routes or trains without this being cause for a civil action to be reviewed by the Attorney General, and reform of Railroad Retirement and Unemployment Insurance (with the goal of phasing out these unique railroad-related programs in favor of coverage by Social Security and regular unemployment programs).

Further study is required in order to discover if, with those changes, a privatized Amtrak might be a viable commercial enterprise. Operating various railfan and luxury trains might be one of the niche markets such a firm could serve, in addition to commuter service in selected markets such as the Northeast Corridor. But the present nationwide network of long-distance, low-priced train service is probably not sustainable even with radical reforms to reduce Amtrak's costs.

#### *Corporation for Public Broadcasting/PBS*

The development of abundant cable and satellite television has greatly weakened the original case for taxpayer support of public broadcasting. The kinds of cultural and educational programming once considered impossible to provide commercially are now available from competing commercial channels. And the fact that more than one firm has recently expressed interest in acquiring CPB or PBS is an indication that these entities have developed valuable programming for which there are, indeed, niche markets.

Privatizing CPB would depoliticize it, ending once and for all the endless controversies between liberals and conservatives over the content of various PBS (and NPR) programs. If Congress judged none of the commercial bids for CPB to be acceptable, an alternative would be to earmark several billion dollars of the proceeds from sale of broadcast frequencies (see below) as an endowment fund for CPB, sufficient to end its dependence on annual appropriations. CPB could then become an independent nonprofit corporation, deriving its annual budget from earnings on its endowment, fundraising and sponsorships, and revenues from licensing and commercial spinoffs (e.g., Barney).

#### SALE OF FEDERAL ASSETS

Much larger than the potential value of Federal enterprises is the potential value of other Federal assets. Table 2 indicates that just eight categories of these might be worth as much as \$300 billion. Even in Washington, DC, as they say, that is real money.

#### *Commodity Lands*

The single largest item is what we term "commodity lands." This means primarily commercial timberlands owned and operated by the U.S. Forest Service and grazing lands owned by the Bureau of Land Management. A 1989 Reason Foundation study, making conservative assumptions, estimated that these lands are worth some \$160 billion at market value.

Selling these lands need not mean consigning them to environmental ruin. Indeed, extensive evidence exists that the Forest Service and the BLM are poor stewards of these lands. USFS, for example, is upbraided by environmentalists for devoting hundreds of millions of dollars to building logging roads in forests whose timber harvests do not produce sufficient revenues to recover the funds expended on those roads. Likewise, BLM's practice of "chaining" rangelands reduces environmental diversity and is decryd by environmentalists.



Both environmental and multiple-use goals can be secured within the context of privatization. Deed restrictions, for example, can require the purchasers of forest lands to continue to provide access for multiple uses—hiking, fishing, hunting, and forestry. Especially environmentally sensitive BLM and USFS lands (where commercial operations cannot be economically self-supporting) can be set aside for sale to environmental groups.

The incentives of owner-users differ from those of tenant-users. The owner of commercial timberland risks a significant decrease in the land's asset value if it engages in environmentally damaging practices such as clear-cutting. The incentive of a firm given a short-term right to cut timber on government land is to harvest as much as possible within its open window; the incentive of the owner of such a resource is to maintain its long-term asset value. The same disparity applies to those who lease versus those who own grazing land.

While it would be politically challenging to create a decade-long program of selling off Federal commodity lands, both the large asset value and the potential of enhancing environmental values argue for making the attempt.

### *Loan Portfolio*

The Federal Government is also the Nation's largest lender—to home owners, college students, and small businesses in particular. Unfortunately, the various agencies involved do a relatively poor job of collecting on these loans. There is poor recordkeeping, and the agencies experience significantly higher rates of delinquency and default than private lenders do.

A loan portfolio is an asset that can be sold for a percentage of its face value, to a buyer that believes it can do a better job of collecting on the loans than the seller is doing. During the 1980's, Federal loan asset sales demonstrated that the Federal Government could receive up to 80 cents on the dollar for its loan assets. Assuming a sale price of between 60 and 80 cents on the dollar, the government's current \$155 billion portfolio could yield between \$93 billion and \$124 billion. Furthermore, the government would be relieved of administrative expenses of some \$2 billion per year.

### *Various Defense Reserves*

Over the years, especially due to the cold war, the defense establishment built up a huge variety of reserve stocks of various commodities. One of the oldest of these is the Naval Petroleum Reserve, at two sites in California and Wyoming. These stocks of oil no longer have strategic value, and their oil is, in fact, sold into the commercial market today. Both the Reagan-era President's Commission on Privatization and the Clinton administration have proposed that these reserves be sold. Their estimated market value at today's oil prices is \$1.6 billion.

A second obsolete reserve is the Federal Helium Reserve, which accounts for 90 percent of the Nation's helium sales. This reserve has a market value of between \$1.0 and \$1.5 billion; unfortunately, its borrowings from the Treasury, plus accumulated interest, total \$1.4 billion, making net proceeds from the sale a wash. But at least the sale would provide a ready means of paying off the reserve's debt.

In addition to oil and helium, the Defense Department acquired immense stockpiles of other commodities during the cold war, much of which is no longer necessary to maintain. These stocks should be sold off over a period of years (so as not to greatly depress the market price of each commodity).

### *Strategic Petroleum Reserve*

As a result of the oil embargos of the 1960's and 1970's, the Federal Government created a huge civilian reserve stock of petroleum. While such reserves could prove valuable in a future situation of unexpected supply shortages, it is the existence of the reserves, rather than their ownership, that is critical. Private institutions could carry out the function of operating such a reserve, and there is some reason to believe that the release of stocks from the reserve in response to market price increases would be more timely and less subject to arbitrary constraints than would be such releases under the current political management. The Congressional Budget Office has estimated the market value of the SPR at \$13 billion, and included its possible privatization in its recent options paper.

### *Broadcast Frequencies*

The Clinton administration has set an important precedent by conducting auctions for the band of frequencies which the Federal Communications Commission has set aside for personal communications services [PCS]. By doing so it has given symbolic recognition to the idea that frequencies are a form of property, an essential component of the means of production of communications services. But while the precedent is useful, the administration's efforts fall short in two ways. First, the

principle of auctions has been applied only to new frequency bands, which are thus far unused. Second, what has been auctioned off is only a temporary right to use the frequency, rather than a true property right. The principle needs to be expanded in both of these areas.

First, the principle of private ownership of the means of production is equally valid for all civilian frequency bands, not just for those currently unoccupied. Among the most important of the currently occupied bands are those used by broadcasters. On the one hand, current licenseholders exist in a kind of twilight zone, in which their studios, antennas, broadcast equipment and all the other means of production are privately owned, but the frequency—without which they cannot broadcast—is held at the sufferance of a Federal agency which can rescind the right to use it in the face of well-organized opposition to the content of the current broadcasting. The ever-present specter of censorship (or self-censorship) is a threat to the first amendment, as well as to the economic viability of each broadcaster's business.

Moreover, the FCC, in its central-planning wisdom, has decreed that certain frequency bands must be used only for the purposes which the Commission has specified—even if alternative uses would be far more valuable. Many UHF broadcast frequencies, for example, are worth relatively little in that use, but those same frequencies, if repackaged for other uses, would command a huge premium. A 1992 FCC study estimated that a single underutilized Los Angeles UHF station's spectrum allocation might be worth \$1 billion if sold off for cellular phone service.

Consequently, a growing number of communications analysts now agree that the existing frequency allocations should be converted to true private property rights and offered first to those who now hold the relevant license. Since a majority of all these licenses are today held by firms which purchased them from someone else (reflecting their economic value), it would be unjust to charge the current licenseholder the full market value (even if government could accurately assess what that might be). Analyst Milton Mueller has suggested instead that incumbents be offered the opportunity to convert their current frequency license into a true property right for a one-time fee. Those frequencies whose were incumbents unwilling to pay this fee would then be auctioned off to the highest bidder. Mueller estimates that such a procedure would raise \$8.6 billion for the Treasury.

Such transactions would be good public policy beyond simply raising revenue that could be used to reduce the Federal debt. By converting a tenuous bureaucratic permission into a secure property right, spectrum privatization would greatly strengthen first amendment protection for broadcasting. In addition, it would encourage the voluntary reallocation of spectrum to higher and better (i.e., more economically valuable) uses, producing large economic benefits for American society.

Table 2 repeats only Mueller's estimate of the proceeds from privatizing broadcast frequencies. The vast array of other spectrum in civilian use—for mobile radio, cellular phones, satellite transmission, et cetera—would be worth many billions more if it, too, were to be privatized in a similar manner, with incumbent licenseholders offered the first option. This, too, would produce economic benefits as more spectrum was reallocated from lower-value to higher-valued uses.

### *Government Buildings and Land*

The Federal Government is the Nation's largest owner of real property. Not only does it own one-third of the country's land area (much of it in the form of the commodity lands discussed above, as well as national parks and wilderness areas), but it also owns huge amounts of valuable urban land and buildings. Moreover, the government owns some \$12 billion of real estate overseas.

It is long overdue for the Congress to review the GSA's detailed inventory of Federal real estate, for the purpose of identifying salable properties, both domestic and foreign. A significant fraction of these holdings appear to be surplus by any reasonable definition. And for that real estate which is required for ongoing governmental functions (despite the current round of downsizing), the government should consider the option of sale and leaseback. Many State and municipal governments are discovering that their in-house costs of operating and maintaining office space are as much as double that of the private sector. Rather than battle endlessly over whether or not to contract out selected operating and maintenance tasks, the GSA could realize these O&M savings by selling many such buildings to professional real estate management firms, and leasing back needed space at rates which reflect private-sector efficiencies.

### INFRASTRUCTURE PARTNERSHIPS

Although the Federal Government provides grant funding for portions of America's transportation and environmental infrastructure, its ownership and operation, as well as the majority of its financial support, lies at the State and local level of



government, as well as with the private sector. During the past 6 years, the Federal Government under both Bush and Clinton, has endorsed the idea of greater private sector involvement in both the financing and the ownership and operation of infrastructure, in part due to recognition that in an era of deficit reduction, Federal resources for infrastructure are more likely to shrink than to grow.

There are two global trends producing greater private-sector involvement in infrastructure. The first is the sale or lease of existing infrastructure enterprises to investors, whereby government-owned airports, electric and gas utilities, highways and bridges, seaports, water supply, and waste-disposal systems are converted to investor-owned enterprises. The advantages here are the same as those discussed previously for the sale of state-owned enterprises. Where the infrastructure facility being privatized has elements of monopoly, its ability to exploit this monopoly at the expense of users must be restricted by some form of regulation, either contractual or via some form of independent regulatory agency. In the past decade both Western industrialized nations (e.g., Australia, Denmark, England, France, Germany, Italy, New Zealand) and developing countries (e.g., Argentina, China, Hong Kong, Hungary, Malaysia, Mexico, Portugal, South Korea) have been privatizing existing infrastructure in this way.

The second global trend is the use of a long-term franchise (generally known overseas as a concession) by which a private firm or consortium is authorized to design, finance, build, own, and operate a new infrastructure facility. In most such arrangements, at the end of the franchise period (typically 20 to 40 years), the facility is to be transferred to the government free and clear. Hence, the common term for such arrangements is build-operate-transfer [BOT].

The principal advantages of using long-term franchises for new infrastructure are several. First, it permits government to tap into new sources of capital, at a time when public sources of infrastructure investment capital are shrinking. Second, experience shows that private firms are able to develop projects in considerably less time than government—sometimes time savings of as much as 50 percent. Third, since time is money, the private sector's speedy design-build methods can reduce a project's investment cost; in addition, a firm that will be the owner-operator (rather than just the designer-builder) has strong incentives to design the facility for efficient, lower-cost operations. Fourth, BOT projects transfer a significant degree of risk from government to the private sector, thereby limiting the extent to which resources get spent on white-elephant projects. Finally, having the private sector own and operate new infrastructure means that these facilities become taxpaying enterprises rather than exempt government enterprises.

At the State level, since 1988 eight States and Puerto Rico have enacted laws permitting toll-road projects to be developed under long-term franchise agreements. A number of local governments have considered the sale or long-term lease of existing airports and water systems. Other local governments have sought to develop new wastewater treatment facilities, often by permitting a private firm to buy their existing plant and expand and modernize it.

The Federal Government has attempted to help with these efforts, thus far without much success. In enacting the Intermodal Surface Transportation Efficiency Act of 1991 [ISTEA], Congress included provisions permitting the sale or lease of existing federally aided highways and bridges (except interstates) in order to facilitate their rebuilding and modernization via private capital leveraged with Federal highway funds. Thus far, no projects have taken advantage of these provisions. President Bush in 1992 issued Executive Order 12803 on infrastructure privatization, in an attempt to reduce barriers to the sale or lease of facilities (such as airports and wastewater treatment plants) that have received Federal grants. Thus far, only one such transaction has been presented to the Federal Government for approval, the sale of a tiny wastewater facility in Ohio. And President Clinton issued Executive Order 12893 in 1993 endorsing the use of private capital in infrastructure and directing Federal agencies to revise their procedures accordingly. So far, there has been little to show for this measure, either.

Despite these problems, the potential for private investment in expanding and modernizing America's infrastructure appears to be quite large. A 1992 Reason Foundation study identified \$227 billion worth of infrastructure facilities owned by cities and States that could be self-supporting as privatized enterprises. Yet realizing this potential will require the removal of significant Federal barriers.

#### LEVELING THE PLAYING FIELD FOR INFRASTRUCTURE

Without intending to do so, the Federal Government has rigged the game against private ownership and operation of infrastructure. It has done this via the tax code, via Federal grant policy, and via regulatory policy. The law in these areas provides



significant economic advantages to an infrastructure enterprise owned and operated by a government agency, in contrast to the identical facility serving the same public owned and operated by investors. In effect, the Federal Government encourages what we call "municipal socialism."

For example, in the tax area, a government-owned facility pays no Federal corporate income tax, and the income on its bonds is exempt from Federal taxation. Both of these interventions confer significant cost savings on the socialized facility, other things being equal. In the grant area, even the Bush executive order (which was intended to help facilitate privatization) still imposes the equivalent of a large transfer tax on the sale or lease of a facility, by requiring that a portion of previous Federal grants be repaid as a condition of Federal approval. In the regulatory area, a number of environmental laws apply a less-stringent standard to publicly owned waste-disposal facilities compared to an identical facility owned by investors.

The effect of all these provisions is equivalent to Congress and the executive branch having determined that it is better for infrastructure needs to be met by government-owned facilities. Given the efforts of recent administrations and Congress to encourage private investment in infrastructure, it is clearly not their intent to thus discourage privatization. But today's reality that the private sector can provide and is providing (worldwide) all the major forms of infrastructure traditionally provided by government is thus far not reflected in current law and policy in this country.

For America to realize the benefits of private investment in rebuilding and modernizing our infrastructure, Congress needs to create a level playing field between government and private ownership of these vital facilities. The tax code should be reformed to treat user-fee supported infrastructure in the same manner, regardless of ownership status. This means removal of the current exemptions from Federal taxation of both corporate profits and the interest income on the revenue bonds issued for such facilities. The latter change alone would ultimately produce some \$24 billion per year in net new Federal revenues, once fully phased in for all new issues of such bonds.

Second, the current grant-repayment requirements in the event of privatization should be removed, as long as the facility continues to remain in the public-serving use for which the Federal grants were originally provided. (In other words, a privatized airport could not be turned into condominiums or even into a private airport serving only members; it would have to continue to be open to the public serving all customers on an equal footing.)

Third, all regulatory provisions and exemptions that currently apply to facilities owned and operated by State and local governments should apply equally to the equivalent facilities owned and operated by investor-owned firms. The key legal criterion should be the use and purpose of the facility, not its ownership status.

Implementation of these reforms would open the door to widespread private investment in revitalizing this Nation's vital infrastructure for the 21st century.

#### GENERAL PRINCIPLES FOR PRIVATIZATION

The preceding discussion leads to a number of general conclusions as the United States considers launching a national privatization effort. Among these lessons are the following.

##### *1. Privatization Is a Major Worldwide Trend*

When privatization was first debated in the early Reagan years, it was correctly seen as something only conservative governments did, and for ideological reasons. The two chief practitioners were Margaret Thatcher's Britain and General Pinochet's Chile. Today, with over 100 countries engaged in privatization, the phenomenon has become nonideological. Socialist governments in Spain and Greece, labor governments in Australia and New Zealand, populist governments in Argentina and Mexico, ex-Communist governments in Hungary and Poland, and Asian "tiger" governments in Malaysia and Singapore are all privatizing state-owned industries such as telecoms, electric power, railroads, and even airports, postal service, and water supply.

The debates in these countries have passed beyond whether to privatize and focused instead on how best to do the job. There is a growing consensus that government should focus its limited resources on core, inherently governmental functions. It should separate policymaking and regulation from actual service delivery—in the words of privatization expert E.S. Savas, it should learn to "steer rather than row."

These governments have all recognized that large economic benefits flow from replacing political management with true business management, from replacing administered prices with market prices, from replacing pork-barrel investments with projects that meet commercial return-on-investment criteria.

The United States can reap similar benefits via a sustained commitment to privatizing Federal assets and enterprises, and encouraging private finance and management of infrastructure.

## *2. Privatization is a Key to Modernization and Competitiveness*

More than half of all the privatization candidates discussed in this testimony involve significant opportunities for technological and organizational modernization, for which the shift to investor ownership can be the catalyst.

The electricity industry is moving rapidly toward deregulation. While this change will be difficult for investor-owned utilities, it is potentially devastating to government-owned electricity firms. Privatization is the best and fastest way to introduce both the freedom and the incentives to reinvent their corporate cultures in ways that will maximize their odds of surviving deregulation as viable enterprises.

Much the same is true of the Postal Service, which is beset by new forms of competition that are rapidly eroding its cash-cow—first-class mail service. And should international postal competition reach our shores (as it has those of Europe), it will take a truly commercial postal enterprise to cope with this additional challenge.

In air traffic control, satellite navigation, the Weather Service, the Geological Service, and NASA labs, the challenge is to modernize these entities' means of production. A downsizing Federal Government is poorly equipped to do this, constrained by dwindling budgets, mountains of redtape, inflexible personnel systems, and an anticommmercial ethos. Rescuing and rebuilding these vital enterprises means redesigning them as either nonprofit or for-profit corporations.

Our transportation infrastructure of airports, ports, and highways also needs reinventing. We need to find a way to institutionalize sound investment decisions, based on return-on-investment criteria. We need to institutionalize proper ongoing maintenance to protect these infrastructure investments. And after a decade of DOT efforts to promote market pricing of transportation infrastructure, we need to acknowledge the public sector's extreme difficulty in charging market prices, and accept the fact that it is relatively easier (and better accepted) for investor-owned firms to do so.

Likewise, our environmental infrastructure suffers from much the same set of ailments as our transportation facilities. Water supply, wastewater treatment, and solid-waste disposal can all be provided by the private sector, and with significantly greater likelihood of sound investment decisions, proper long-term maintenance, and market pricing that promotes conservation.

Finally, spectrum (frequencies) is increasingly being recognized as the key economic resource on which much of the benefits of the information/telecommunications revolution will depend. Putting spectrum into the marketplace will put more of it to its highest and best (i.e., most economically valuable) use.

In all of these ways, privatization will lead to a more productive, more competitive economy.

## *3. Worker/Management Ownership*

It has become routine for the privatization of state-owned enterprises to include the provision of a fraction of the shares to workers and managers, on preferential terms (e.g., at a discount from the offering price). Doing so is politically wise, since it offers the employees a form of compensation for giving up the protections of civil service and adjusting to the rigors of operating in a competitive marketplace. This practice is also economically wise, since it provides a very tangible incentive to the workers and managers to make the enterprise a commercial success. When they can see that improved efficiency translates into profits which translates into increased dividends and increased stock value, they are more likely to propose and accept changes in procedures, work rules, and possibly even entire lines of business. Employee stock ownership is also organizationally wise, in that it directly addresses the need to change the corporate culture of the enterprise from bureaucratic to entrepreneurial. Worker/management stock ownership should be included as a provision of the sale of Federal enterprises whenever possible.

## *4. Customer Share-Ownership*

As with workers and managers, the customers of utility-type enterprises may also fear that privatization will be to their disadvantage. In this case, the concern will be over the possibility of higher rates and charges. Utility privatizations should therefore include provisions that make it easy for customers within the utility's service area to purchase stock at a discount, and possibly with payments made over time, via their monthly utility bills. Although the concern with large rate increases may be exaggerated or unrealistic (for reasons noted previously), a bona-fide way of compensating ratepayers for the shift to a privatized utility should reduce the extent of opposition from that quarter.

### 5. Level Playing Field

The previous discussion of infrastructure has made clear that the Federal Government has inadvertently rigged the game against investor ownership and in favor of "municipal socialism" for utilities and other infrastructure. Once it is recognized that either form of ownership is feasible, Congress should remove the biases from Federal law and the tax code, so that State and local governments can choose between these alternatives on their merits, rather than because of interventions by Washington, DC.

Specifically, this means permitting cities and States to sell or lease federally aided infrastructure facilities without extracting a "transfer tax" in the form of a requirement to repay Federal grants. It means applying the same regulatory treatment to investor-owned and government-owned infrastructure facilities, so long as both serve the public in a similar manner. And it means equalizing the tax treatment of user-fee-supported infrastructure, making both government-owned and investor-owned facilities liable for the same corporate income taxation and the same degree of taxation of interest on their bonds.

#### IMPLEMENTATION ISSUES

As shown in Table 3, a serious privatization agenda could produce \$382 billion in one-time proceeds, which should be earmarked for paying down the national debt. In addition, three other impacts would reduce the government's annual budget deficit. First, elimination of current operating costs and/or subsidies would yield over \$11 billion per year in savings. Second, Federal corporate income taxes on the privatized Federal enterprises would generate an estimated \$13 billion per year. Third, the reduction in the national debt (thanks to the asset-sale proceeds) would lead to annual interest savings in the vicinity of \$29 billion. Together, these three savings total \$53 billion per year. In addition, by the end of the transition period for phasing out the exemption from Federal taxation of interest on infrastructure bonds, there would be additional annual Federal revenues of \$24 billion per year. Altogether, this agenda would lead to permanent deficit reduction of \$77 billion per year.

It should also be noted that these numbers may understate the full potential savings from Federal privatization. Tables 1 and 2 are incomplete in two ways. First, some of the annual savings estimates were not included, due to the unavailability of hard numbers at this time. Second, other assets and enterprises (e.g., nonbroadcast frequency spectrum) can undoubtedly be added to these lists, producing further sales proceeds and the associated annual savings. So the total proceeds and annual savings from a full-fledged Federal privatization agenda would be larger than what is shown in these preliminary tables.

While these numbers in the aggregate provide a meaningful contribution toward the goal of a balanced budget, most of the individual items are rather small (a billion here, a billion there, etc.). The problem is that with each individual Federal asset or enterprise having a constituency defending its status quo, and with those constituencies well-represented before the committees that have historically dealt with that asset or enterprise, the gains from each isolated privatization may appear to be not worth the cost of the struggle to bring it about. Once again, the tyranny of the status quo may prevail—even though most people would agree that the aggregate result of achieving the whole agenda would be worthwhile.

This problem is analogous to that faced by advocates of closing surplus military bases in the 1980's. Congressman Dick Armey proposed the breakthrough solution of a Base Closing Commission, which would have carte blanche to identify, on the merits, a whole set of bases which were good candidates for closure. Congress agreed to bind itself to accept or reject the entire package of recommendations in an up-or-down, no-amendments-possible vote. This mechanism permitted Members of Congress to do what was right despite the potential of short-term pain in their individual districts.

A similar mechanism might prove equally useful in the case of privatization. A Privatization Commission could be charged with identifying, each year until a balanced budget has been achieved, a package of Federal assets and enterprises to be privatized, along the lines discussed in this testimony. Alternatively, this task could become an explicit part of the mission of the Spending Reduction Commission proposed by Senator Connie Mack and Representatives Dan Miller and David Minge. Either way, the independent, bipartisan commission would produce an annual list of proposals that would be voted on as a package, without amendment, in an up-or-down vote.



TABLE 1.—SALABLE FEDERAL ENTERPRISES

[In billions of dollars]

Name	Sales revenue	Annual savings
TVA .....	\$12.0	( <sup>1</sup> )
5 PMA's .....	14.0	\$1.8
Dams (Corps, BuRec) .....	20.0	( <sup>1</sup> )
GSA, VA DOD energy facilities .....	<sup>2</sup> 10.0	( <sup>1</sup> )
U.S. Postal Service .....	8.1	0
Air Traffic Control .....	0	1.8
Global Positioning System .....	7.0	( <sup>1</sup> )
U.S. Enrichment Corporation .....	1.0	( <sup>1</sup> )
National Weather Service .....	2.5	0.4
U.S. Geological Service .....	0.5	0.6
4 NASA Aeronautics Labs .....	1.5	0.3
Amtrak .....	0	1.0
Corporation for Public Broadcasting .....	<sup>2</sup> 0.3	0.3
<b>Total</b> .....	<b>76.9</b>	<b>6.2</b>

<sup>1</sup> Reliable data not available.<sup>2</sup> Estimate.

TABLE 2.—SALABLE FEDERAL ASSETS

[In billions of dollars]

Name	Sales revenue	Annual savings
Commodity lands (USFS, BLM) .....	\$160.0	\$3.0
Loan portfolio .....	108.0	2.0
Naval Petroleum Reserve .....	1.6	( <sup>1</sup> )
Federal Helium Reserve .....	0	( <sup>1</sup> )
Defense stockpile .....	<sup>2</sup> 1.0	( <sup>1</sup> )
Strategic Petroleum Reserve .....	13.0	( <sup>1</sup> )
Broadcast frequencies .....	8.6	0
Government buildings/land .....	5-20	( <sup>1</sup> )
<b>Total</b> .....	<b>297.2-317.2</b>	<b>5.0</b>

<sup>1</sup> Reliable data not available.<sup>2</sup> Estimate.

TABLE 3.—OVERALL PRIVATIZATION SAVINGS

[In billions of dollars]

Type of sale	One-time proceeds	Annual deficit reduction			State corporate tax <sup>3</sup>	Local property tax <sup>4</sup>
		Interest savings <sup>1</sup>	Subsidy elimination	Federal corporate tax <sup>2</sup>		
Enterprises .....	\$76.9	\$5.77	\$6.2	\$2.61	\$0.77	\$1.15
Assets .....	305.2	22.89	5.0	10.38	3.05	4.58
<b>Total</b> .....	<b>382.1</b>	<b>28.66</b>	<b>11.2</b>	<b>12.99</b>	<b>3.82</b>	<b>5.72</b>

<sup>1</sup> Interest calculated at 7.5 percent on Treasury bonds.<sup>2</sup> Federal corporate tax rate of 34 percent on revenue equal to 10 percent return on asset value.<sup>3</sup> State corporate tax rate of 10 percent on revenue equal to 10 percent return on asset value.<sup>4</sup> Property tax rate of 1.5 percent of asset value.

Mr. SMITH OF MICHIGAN. Thank you, Mr. Poole. In Michigan, the State where I am from, we have found it very difficult to change some of the quasi-governmental units, the corporatization from the partially government controlled to the private sector. I guess the question is, is setting up these corporatizations where they are government institutions a way to privatization or is it sort of the final result and results in total privatization being prevented? Maybe if all of you could give a short response.

Mr. LINOWES. It seems to me that is an interim step that is very helpful to segment out the facets of the operation that are relevant for a business operation and should be privatized. It is desirable to have that interim step.

In overseas developing nations it is especially essential. I recall when I was in Yugoslavia before the break-up, they were seeking advice on how to privatize. The question had to be resolved of who has the authority and who would receive the proceeds when they sell a steel mill, for example. That step of clarifying all the legalistic requirements as well as identifying who goes with what is very essential. Comparably, we have the same problem in a different scale. Setting up a quasi-institution can be a helpful beginning.

Mr. SMITH OF MICHIGAN. Mr. Dale, New Zealand has quite a bit of experience in corporatization.

Mr. DALE. I think the answer is it can be both. Certainly in New Zealand corporatization has resulted in enormous efficiency improvements in the activities that have been corporatized. For example, the railway company, New Zealand Rail, before it was corporatized it had staff of about 24,000, 25,000 and hauler protection on all its rail routes, freight protection. A year or so ago, 6 months ago, a year ago when it was actually sold it had staff of about 5,000. So we went from 25,000 to 5,000, and a vastly improved rail service over both freight and passengers by most people's view. And the transport industry generally was greatly improved by the opening up of competition.

So you can get enormous efficiency improvements through the corporatization process if you open it up to competition in each market. There may be good reasons why a government wants to retain an operation in that form, particularly if there are regulatory issues attached to it, or monopoly issues attached to it.

But we have also found that corporatization is a very helpful stepping stone to privatization. We have found it is a much easier form to privatize from. When you have got a company and it has done its restructuring, and it is quite profitable and quite properly focused, it is much easier to privatize from that situation.

Mr. POOLE. I am worried about this step in the United States context for the following reasons. In New Zealand when they say corporatization they mean creating a commercial corporation that simply has government as its shareholder.

Mr. DALE. That is correct.

Mr. POOLE. With our experience in the United States, when we create a government corporation that is not what we mean. What we have usually done with government corporations like the TVA or the Postal Service is create a slightly less bureaucratic bureaucracy that does not have a clear commercial mission, does not have a private sector board, does not use generally accepted accounting principles, can still borrow at subsidized rates from the Treasury, et cetera, et cetera. It is not at all like what is done overseas when they use the word corporatize.

So I think you have to be very clear about what your objective is. If your objective is ultimately to privatize, you need to create a commercial corporation as a first step that still has government as the shareholder.

But also, I would recommend strongly setting a deadline to really enforce it. And set that in law that says, we are going to turn, let's say, the Postal Service into a corporatized operation, but it has 4 years in which to reorganize and at that point it will be sold. Have that deadline be in the law and have the charge to the management and board that comes in, that that is your mission in life. It is not to simply make it more efficient. It is to get it ready for the rigors of the marketplace.

Mr. SMITH OF MICHIGAN. My postal workers were in yesterday and they said, do not privatize the postal system because what will happen is the highly profitable areas will be privatized and it will leave your hometown, Mr. Smith, without any service because that is a remote area out in the woods. Can you react to that argument of privatization of government functions and the potential lack of service in low-profit areas?

Mr. POOLE. Sure. That is an old saw and I think it is very important to look at what is out there. The fact is that UPS and Federal Express will deliver to anywhere in the United States. It is in their interest to be able to have a network that connects all the dots, so to speak. I think it is highly likely if we were to effectively privatize the U.S. Postal Service it would have every incentive to continue to provide those services.

Now it might need to charge a somewhat higher price to serve rural areas. That is a policy choice that you could make. There are two ways to deal with it. You could either say, it is commercial. People who live in rural areas have the benefits of cleaner air and less crime. They may have to pay a little more for groceries and mail service.

The other approach is to create a subsidy program like Congress did with airline deregulation. Congress created the Essential Air Services subsidy program that guaranteed to help pay the costs of airlines serving rural areas. Former budget director Jim Miller when he was budget director did some calculations that indicated that it would be a few hundred million dollars a year to subsidize mail service in rural areas. Compared to the total dollar volume of the Postal Service, that is a trivial amount. I would happily pay that price in order to have the benefits of a truly efficient customer-oriented Postal Service.

Mr. SMITH OF MICHIGAN. Let me ask a last question and then I will turn it over to Mr. Sabo. Between the three of you, considerable experience in where we go with passenger rail. Of course, that is one of the discussions of this committee. One question I have not been able to solve and maybe you can give me/us some guidance would be, if we were to, for example, privatize Amtrak and said, if you can survive, survive out there and figure out some kind of a reasonable transition.

It seems to me that since it is not easy to get into the business once you are out of that business, trying to predict the extra pressure and market demands that might be put on other forms of transportation whether it is air, sea, or bus, or whatever, it seems to me there needs to be somewhat of an accurate or an effort to make that prediction before you pull out since it would be so difficult once you are out to continue that service. Let's start with Professor Linowes and go across.



Mr. LINOWES. I think transportation of that type falls into the category of the welfare of the people. We cannot risk not having that facility. There has to be a hesitation before you turn completely to private interests in this regard. But, you can take an interim step. We can begin privatizing certain parts of Amtrak, whether it is the food service or some of the various elements, maintenance of track or even parts of the track so that the private sector will develop some experience and feel for what has to be done.

As a matter of fact, our government stepped in because it was considered in the interest of our Nation when they took control of Amtrak and Conrail. It was because of problems with the unions. The management, the private ownership, found that they were at loggerheads. The government acted properly because it was an important need. We do have to be careful in how we make that transition.

If presently under government operations it is not economically feasible to function on its own, the private sector most likely could not. We would have to know what the plans are, what private interests would do in order to make it economically feasible. That would have to be resolved in negotiation.

Mr. SMITH OF MICHIGAN. Mr. Dale.

Mr. DALE. I guess from the New Zealand perspective, we have come to understand that government can still have a significant influence without owning operations, both in a regulatory sense and a fiscal sense. The New Zealand Government does provide a series of transport subsidies, both at rural and particularly at the urban level to support both bus and train operations in the urban areas. So the government is able to meet its social objectives through that mechanism without necessarily owning the railway company or any of the bus companies.

In effect, again to put competition into that process, the subsidies are actually essentially tendered for. So competing bus companies can tender for a subsidy to run an urban bus network, and the train network has to compete with that as well. So there are other mechanisms to deal with the sort of issues you are concerned about other than ownership.

Mr. POOLE. I wanted to point out also, there is a trend worldwide, and it is definitely going on in Britain today with the impending privatization of British Rail, to shift from one monolithic organization providing passenger rail service to opening it up to people who would bid to provide service on specific routes. Whoever bids requiring the least subsidy would be the provider on that route. So if Congress determines that there needs to be rail passenger service in areas where Amtrak is currently losing a large amount of money, which would be most of its route service, an alternative to consider would be to put those individual routes out to bid and see who would need the least subsidy to provide a given level of service.

Now you still, I think, would need to do dramatic, significant labor regulatory reform in order to make it feasible for anyone to do a job that would be much better than what Amtrak is able to do, because being burdened with the Federal Employers Liability Act and the Railway Labor Act and Railroad Retirement really

makes the cost of running that service enormously higher than it would be under more normal market-like labor relations conditions.

Mr. SMITH OF MICHIGAN. Mr. Sabo.

Mr. SABO. Thank you, Mr. Chairman. Mr. Dale, I am just curious, how do you organize and pay for health care in New Zealand? And what is happening with cost escalation?

Mr. DALE. I have to first admit that it is not my area of greatest expertise. We are in the process of significant reform of the health care system in New Zealand from a system where health care was provided through a series of local authorities, each of whom had an elected board, to a system where—so I need to preface this that health care in New Zealand is predominantly funded by the central government. Nearly all funding of health is from that source, and most of the hospitals in New Zealand have in fact been state hospitals. There are a few private hospitals, but mostly government-owned hospitals.

We have now set up a system where the hospitals are set up as a commercial activity, commercial hospital and funding is distributed to them by a separate organization whose job is to fund those health care providers. They fund them on the basis of cost of various procedures and they bid for that. It is a way of rationing the health care dollar through that process.

Mr. SABO. I was just looking at your criteria. I was trying to sort them out. I gather that the government enterprises, and what is very fundamentally different in this country in comparison to most countries is that we have very few to start with. But when you are selling, I take it from your criteria, if it is making good money you do not sell.

Mr. DALE. Not necessarily. It is all about whether the money you are currently making is greater—I mean, the net present value of the current stream of profits is going to be greater or less than the sale price you are going to get from it. Now our sort of starting assumption was that in most cases the private sector would do a better job at managing the organization, would therefore create greater profits than would happen under government ownership. Therefore, they are prepared to pay more than the revenue stream under government ownership, and that has proven to be the case.

The Auditor General in New Zealand has kept a close eye on the privatization process, has been concerned that the government has got the best value possible for its sales, and has several times given the—

Mr. SABO. You do not have fire sales.

Mr. DALE. No, we have not been in that game. But I should make it clear that in many cases the government had to restructure these organizations before sale. In the case of the railways, for example, which when they sold that network, that was only after a significant financial restructuring of the railway company including the government taking on a sizeable portion of debt of that railway company. So there is some up-front financial cost in many cases.

Mr. SABO. Thank you.

Mr. SMITH OF MICHIGAN. The gentleman from Kansas, Mr. Brownback.

Mr. BROWNBACk. Thank you very much, Mr. Chairman, appreciate that. Dr. Poole, I would like to ask you a couple questions. Appreciate your testimony, the specificity of it, the thought that you have put into this over time. I have privatized government functions at a State level and the Reason Foundation provides a good intellectual backdrop to be able to do that in.

You talk on page 7 of your testimony about privatizing the National Weather Service, an idea that I am certainly intrigued by. A number of us would like to see us eliminate the Department of Commerce and take certain core functions, privatize them, put them back to the States, or there are certain that should be kept. In looking at the Weather Service a lot of people argue that we need that for a basis to be able to predict storm activity, tornados. How would you address that particular issue in privatizing the National Weather Service?

Mr. POOLE. I think there is a general impression that gets around with privatization that if you privatize something it is no longer going to be available. That simply is not true. We are not talking about abolishing the Weather Service, we are talking about changing its form, making it a more commercialized type of entity. The government could continue—if the government decides that farm weather information is an important responsibility that the government needs to continue to guarantee, the government could purchase that element of weather data from the weather corporation and essentially retail that to farmers if it turns out that for some reason that would not be a commercially effective thing for the corporation to do.

When we looked at this about 6 years ago, we concluded that most of what the Weather Service does is the generation of information that is retailed by somebody else, by broadcast companies, or it is used by large concentrated interests like airlines or shipping companies, and that there seemed to be very little problem in ensuring that someone was there who had an incentive to make the relevant weather information available to the different categories of users. But clearly, if there is any problem of potential market failure, the government can be one of the customers and can provide the targeted information to the people that it decides needs it.

Mr. BROWNBACk. So we just buy the service to predict hurricanes, tornados, and that sort of information?

Mr. POOLE. That is correct.

Mr. BROWNBACk. And we would be much more selective then in what we pay for.

Mr. POOLE. That is correct. An awful lot of the other services there are clear commercial customers for. The broadcast media and print media, they want—a lot of them buy their weather reports now from private firms who in turn get their raw data from the Weather Service. So there already are a lot of market structures out there.

What we are really talking about here is freeing up the personnel, the dedicated meteorologists and staff in the Weather Service to do a better job of adding value to their products and being able to be more commercial in the way they operate. Also, by having their own ability to market data and keep the proceeds, to be able



to fund modernization and supercomputers and things like that, which they often have a difficult time doing now in the constraints that they operate under.

Mr. BROWNBACK. Another area that I am interested in is Department of Energy and some of the work that it does and getting it out in the private sector. Quite a few questions have been raised as to whether we lose money by selling off some of these assets. Some people raised the question on the Naval Petroleum Reserves, that we should hold onto the oilfield because we will lose more money than we will gain by selling it. Are you familiar with those arguments and could you address those?

Mr. POOLE. I am. Part of what that neglects—I mean, it is easy to crunch numbers and make them come out the way you are pre-disposed to make them come out. Part of what is neglected there is the tax revenues that would be raised for local, State, and Federal governments by having that operation in the private sector. When you actually factor in the tax payments that would be made by private owners of that resource, the numbers that I have seen indicate that this would clearly be a net gain and that there is no good reason for government to hold onto this.

I think particularly at a time when—this looks like now an issue where there may be a lot of bipartisan support with, I believe the Clinton administration has endorsed in its budget proposals privatizing the Naval Petroleum Reserves. I would say strike while the iron is hot, while there is the possibility of getting real bipartisan support on that.

Mr. BROWNBACK. So you think that the numbers do support the sale of that and that we do—

Mr. POOLE. I think they do. When you include all the relevant income flows they do.

Mr. BROWNBACK. Thank you, Mr. Chairman.

Mr. SMITH OF MICHIGAN. From the great State of Florida, Ms. Meek.

Ms. MEEK. Thank you, Mr. Chairman. I would like to thank the presenters for the provocative statements they have made today. I am very much interested in Professor Linowes' presentation in that I think that he presents an excellent academic and intellectual argument toward how we can do privatization. Yet there are some very practical things that I would like to ask you about.

In your paper you mention the schools, and because that is my background I would like to question you about that. One of the things you mentioned, Professor, had to do with the cost of educating an average student in a school. I am wondering if you considered the fact that all the students are not the same, that there are many exceptional students in our school system. You cannot really educate all of them for an average of \$5,000 a year. Now many of our school systems do it for less than that.

But with all the other costs that are involved when you have exceptional students, retarded, all kinds of students, I am wondering if you took that into consideration in your cost analysis of the voucher system. That is one of the reasons why I have been against the voucher system over the years. Would you address that?

Mr. LINOWES. Sure. That statistic was just inserted there incidentally. In my judgment, very little that involves privatization, in-

cluding choice, especially choice in education, should deal head-on with the budgetary advantage or saving money. What it should deal with is quality of performance. What I am interested in, especially when we talk about education, is giving a student a choice. So if he is assigned to one public school where the administrators and teachers are very ineffective and inefficient and just do not care, he should have a choice so he can go someplace else and not be a captive. That is the essence of what I am trying to address.

Now insofar as what was injected into those statistics, I don't know. I did not design those statistics. They were designed by a nonprofit organization. But I want to quickly add, some public schools are far superior and no doubt are more costly. Our whole approach to financing education is very weak and needs complete realignment. It is based on real estate, based on values. Those people that need educational opportunities the most have the least amount of money available to them. They often reside in minority areas.

I would prefer that we put aside the financial dimension. It was just an incidental point that I thought should be of concern. But clearly, if I were to give it a percentage, I would say maybe 5 or 10 percent. The main thrust is, how do we improve the educational system in our Nation.

Ms. MEEK. I agree with you, Professor, on the rationale of what you are saying. Yet, since our main goal here is to think about cost reduction, I had to bring up that point.

The second thing I am concerned about, Professor, is the issue of affordable housing opportunities. I wanted also to draw to your attention that it is very good to give a poor person a voucher and ask them to go out and find a house, but that is not easy in the market today. I saw this in Florida when the hurricane devastated Dade County. The government provided all kinds of vouchers for them to find homes, but yet 3 years have passed and very few of them have found them.

I have heard a lot about privatization and I must say it is provocative, and I am being strongly influenced because of the information we are receiving here. But I have yet to hear something that is really going to hit at our major problem. In each one of your papers each of you has approached cost-saving techniques as well as having a strong rationale. But neither one of you has talked about our major drain, and that is the health care system.

How do we take this major drain into consideration? I think all of your ideas are good for privatizing and saving money in increments. I think that is good. But I do not think even if we did that very well we would be able to solve our problem unless we close the gap of these big things like health care that are costing us all this money—and all these entitlements. Could you address that?

Mr. LINOWES. Yes, as a matter of fact in my written testimony I did make reference to health care and our Commission did examine that issue extensively. In Medicare, which is the area of health care that seems to be exploding in terms of cost, we urged that there be injected a voucher approach so that the patient himself has some incentive to try to limit the number of visits and the type of medical care he seeks. Right now the patient has no interest even as to whether or not he needs that attention. What we have

to do is put into the hands of the patient the equivalent of his paying for it out of his own pocket. A voucher should take care of that.

As a matter of fact, it could be made universal. The average cost of medical care in this country is in the area of \$3,400 a year. Why not assign a voucher, say of \$3,000 to be cumulative so that if a person only needs \$700 or \$800 worth of medical care one year, the balance carries on, so that it builds up for when he gets older. There has to be a mechanism so that everyone has the same opportunity to select.

I would like also to comment on your housing point. Again, it is dealing with the element of choice. I certainly understand people having vouchers and not being able to spend them. That dovetails with the problem of rent control in many cities.

In our report we emphasize the importance of repealing rent control. As long as you have rent control you will not get builders to build any kind of housing because they first have to be able to stay in business. If they find when they finish building an apartment unit they are locked in so that they cannot even recover their cost, let alone the operations, they just do not build. That is precisely what has happened throughout the country, especially in housing for the poor.

Rent control does not help the poor. It is one of the most harmful devices that we have used. We have to dispose of rent control, then give them vouchers. Then they will have plenty of opportunities.

Mr. SMITH OF MICHIGAN. Mr. Hoekstra from Michigan.

Mr. HOEKSTRA. Thank you, Mr. Chairman. I would like to express my appreciation to the panel. The testimony has been very fascinating. I have got questions in three areas.

Mr. Poole, I see this big number up here, one-time proceeds \$382 billion. I am just wondering how inclusive you believe this list to be. It does not say anything about public housing. Is this intended to be an all-inclusive list or is this what you think might be a quarter—

Mr. POOLE. It is not intended to be all inclusive. It is intended to be a good first start of things that there has been some research on, things that provide reasonably well understood targets of opportunity, if you will. I think it probably covers between a half and three-quarters of what is really out there. But it is certainly intended to be a preliminary list rather than the final list.

Mr. HOEKSTRA. Professor, in your report had you guys tried to come up with an amount or the value or to quantify in any way the privatization aspect?

Mr. LINOWES. No, there are so many different facets of it. Our thrust was how we can get government to produce. Quality performance is our emphasis.

Let me make an observation about the Commission. It was clearly a bipartisan commission. We had President Carter's director of Office of Management and Budget on that Commission. We had Walter Riston, the former CEO of Citibank. We had Mel Laird, we had the president of a steelworker's union; clearly a Democrat. We had, I do not know how many, Democrats and Republicans, they were not identified.

Our report was unanimously approved. Every one of those recommendations, and the types of things I am talking about, espe-



cially getting away from just handouts. The handout is OK as long as there is accountability, and you will get accountability with a voucher.

Mr. HOEKSTRA. Thank you. Mr. Poole, I am real intrigued by this idea of municipal welfare. I fly out of a county-owned airport. Are you suggesting that by perhaps phasing out the interest deduction or the tax-free characteristics of these bonds that this county airport or this county board of commissioners over a period of time may decide that it is in their best interest to privatize?

Mr. POOLE. Yes.

Mr. HOEKSTRA. This is what you are saying, we are really driving this whole concept of government ownership through all levels of government, and that if we take away some of these other incentives we might actually see more privatization encouraged at local levels?

Mr. POOLE. I am sure we would see a lot more of it. I think it should not be the Congress' position that you should direct cities and States that you should have all private airports or all private water systems. You should simply remove the biases that are built into Federal law today in the tax code, the regulatory structures, and the Federal grant programs that make it awfully hard for anybody to privatize these things because you have got such a big economic hurdle to overcome thanks to the tax code biases and so forth.

I do think, though, that creating this kind of a level playing field would, over time, leads to a lot more use of the private sector either on a contract management, a lease basis, or full ownership basis.

Mr. HOEKSTRA. I think it is a real intriguing option because I am sure if they privatize it they lose the headaches. At the same time, the other things that you pointed out, you also now get a great asset for local taxes.

Mr. POOLE. Expand the tax base, that is right.

Mr. HOEKSTRA. The third area again is, and I think this focuses on also what the professor identified in his testimony is that—I really applaud the effort here—is that it is a focus on quality. It is a focus on results. It is not primarily a cost-cutting type of effort. I am also serviced by one of these Amtrak lines that is losing a phenomenal amount of money supposedly. Of course, we cannot get the actual correct numbers.

Is there any reason to believe that the privatization we might actually see when Ms. Molinari corrects many of the labor law problems that are affecting the railroads and these types of things, is there any expectation that perhaps we might see increased services and a higher quality of service? That by privatizing it we may not necessarily be in a retrenchment mode.

Mr. POOLE. I think in some areas there may be. Reason Foundation is organizing a summit meeting in about 3 weeks in Denver of people that are involved in the private rail passenger charter business. Many of them are very concerned about the potential demise of Amtrak. We are going to try to pick everybody's brains to look at what do people with a lot of real railroading experience think about the potential for ways of still providing passenger serv-

ice even if there is not going to be \$1 billion a year spent by the Federal Government on this.

It is interesting that in Britain where they are in the process now of privatizing British Rail partly through franchising individual routes, people like entrepreneur Richard Branson of Virgin Atlantic Airlines is heading a group that is proposing to provide new kinds of passenger rail service over the lines that will still remain owned—actually they are going to privatize the roadbed too. But the actual roadbeds are being separated from the passenger service provision.

So I think we do not know yet, but there are a lot of firms, there is quite a market around the world for charter rail service, for luxury trains, for tour groups and things. It may not be exactly the same kind of thing that Amtrak now provides, but I think there are some real possibilities out there if we can be creative and also learn from what other governments are doing.

Mr. HOEKSTRA. Thank you very much.

Mr. SMITH OF MICHIGAN. The gentleman from New Hampshire, Mr. Bass.

Mr. BASS. Thank you, Mr. Chairman. Mr. Poole, in reviewing your testimony I note in the first paragraph you say, "I have done research on this subject"—the subject being privatization—"under the auspices of the U.S. Agency for International Development and the World Bank." I was wondering if you would be willing to make some observations on privatization in those areas.

Mr. POOLE. You mean of those institutions?

Mr. BASS. Yes, sir.

Mr. POOLE. I do think that much of our foreign aid function has a poor track record over the years. Rather than privatizing it, I think it would be better really to simply abolish virtually all of our foreign aid and allow private institutions that can provide economic development advice, that can do relief of disasters and so forth to do that job. Perhaps increasing the ability of people, of individuals to deduct contributions to such organizations would be a way of further helping to expand the supply of private assistance. But I do think that would be a worthwhile thing to do.

The World Bank, I think could readily be privatized. Its role would have to change somewhat, but increasingly in the last few years the World Bank has started dramatically encouraging privatization of government enterprises, and bringing in private capital and the use of the private sector in infrastructure, which is why they have asked me to do some consulting for them.

But I think that could be turned into a commercial institution providing loan guarantees and this kind of thing; a smaller role than it plays now. But the direction that it is going has been clearly one that is in support of the kind of agenda that I am talking about, and it needs to have those same principles applied to its own organization.

Mr. BASS. How do you set priorities, or should you set priorities in foreign aid through privatization?

Mr. POOLE. I do not like to get into that debate because I really do not think that the government should be carrying out that function in the first place. Disaster relief is something that there are lots of private organizations, International Red Cross and so forth

that are able to do. An awful lot of foreign aid, if you look at the objective record over the years, has funded boondoggle projects, has created environmental destruction, has caused a lot of harm, has enriched elites in capital cities at the expense of people in the countryside.

So I think the best thing we could do would just to be to really dramatically shrink foreign aid. At a time when we need to find budgetary savings that seems to me to be a pretty obvious target.

Mr. LINOWES. May I make an observation with reference to that?

Mr. BASS. Yes, sir.

Mr. LINOWES. One of the problems with our foreign aid, both through international organizations and our own, is we tend to lend aid to the governments involved, the institutions, and not to the private individuals, the private sector. That is an important weakness. If some development is needed we send \$10 million to the government and the government then passes it out as it sees fit.

I remember when I was in India helping them with their economic development—this was when Indira Gandhi was Prime Minister—she would absolutely refuse to allow any institution to even try to seek funds. I recall dealing with one entrepreneur who was quite wealthy, had interests in banking and manufacturing, had an idea for housing development for thousands of units at a time very inexpensively. He tried to get loans from our government and from the World Bank. But because the procedures set in place was they could not lend directly to the individual, or they would not, it had to go through the government. Indira Gandhi refused to allow him to expand his empire.

The World Bank and intergovernmental institutions, I understand, are beginning to shift to lending money directly to private sector individuals rather than directly to the government. When it goes to the government, for some reason a large percentage just fades away, whether it is bribery or other aspects that is completely unaccountable. By directing our funds to the private sector I think we could have a substantial improvement.

Mr. BASS. Thank you very much, Mr. Chairman.

Mr. SMITH OF MICHIGAN. The gentleman from Illinois, Mr. Costello.

Mr. COSTELLO. Thank you, Mr. Chairman. Professor Linowes, you mention in your written testimony on page 5 that the government should never abdicate responsibility for making policy. You go on to state if, for instance, if the Air Traffic Control System, if we decided at the Federal level to privatize that System that the Federal Government would—you would not be comfortable with just turning the Air Traffic Control System over to privatization. I wonder if there are other services that the Federal Government provides that you believe either should not be privatized or where you have major concerns of privatization.

Mr. LINOWES. It is not just a matter of privatization. We have it in the Post Office. But I think a responsibility of government is to look after the welfare of the people. That does not mean operations. The trouble is, we get ourselves involved in operating. We should exercise monitoring or surveillance, if you will. In every



area that is important, whether it is transportation, air traffic control, Post Office, we must never abdicate monitoring responsibility.

If we had not abdicated responsibility during the savings and loan expansion, we would not have had the problem we did have. We have so diverted the efforts of government by performing operations and not paying enough attention to overseeing and surveillance. We should always have oversight in every area.

Mr. COSTELLO. Is there any service whatsoever that the government is providing to the people that should not be privatized? In other words, we should continue to provide that function at the Federal level and should not have——

Mr. LINOWES. That question comes up. Of course, security, military it seems to me should not be privatized. There are certain areas, types of things such as water, whether we privatize—the actual functioning of purifying water could be carried out privately, but we should always have that responsibility. Lawmaking, for example, is something that does not lend itself to trying to get a third party to make decisions for us. It is a matter of identifying almost every function that we have in our complex society and making an in-depth analysis of it.

Mr. COSTELLO. Thank you, Mr. Chairman.

Mr. SMITH OF MICHIGAN. The chair of our subcommittee on rail for the United States, Ms. Molinari.

Ms. MOLINARI. Thank you, Mr. Smith. I would like to take this wonderful opportunity, if I may, to prolong this hearing for a few more minutes to hear from our panel. On March 21 we will be re-authorizing Amtrak. I have read through a portion of your book, Professor, and basically I think we are moving in near lockstep in terms of your recommendations. If you could expand upon it a bit. Then, Mr. Poole, if you could follow up relative to the seminar that you have been talking about, to perhaps outline for me in both your testimonies how you think we can at least temporarily deal with a public-private partnership in running Amtrak.

Mr. LINOWES. Of course, the point was made here, and it is one that my Commission delved into considerably, and is separating out the different units. The rolling stock is one unit, food service is another unit. If we want to go hesitatingly into privatization, let the government continue to maintain the roadbed and charge a fee to whatever private companies to buy the operating trains, the rolling stock. It is a matter of imagination and negotiation with those that would be involved in the operations.

In our own probing and our own hearings that we conducted, we did bring in those at the operations level and we know it is feasible. Yet we recognize that every one of the functions will not necessarily be economically practical for the private sector. We have to break it down to its different elements.

Perhaps the maintenance of the railroad stations could be turned into a commercial enterprise; a center from which you could establish retail stores and units. No outside observer dreamt what FedEx was going to do when it got into the business. The genius of bringing everything together in one spot and then fanning it all back out again was completely foreign to the way we felt you would carry on any kind of postal or delivery system.

The idea is to push into the imagination what is out there. Present the problem and then negotiate from that point. With Amtrak itself, I believe from what we have seen, breaking it down to its elements is feasible. In response to a point mentioned earlier, I shy away from subsidization because there is no end to it. We have our share with the Post Office in various forms of subsidization. There is no end to it. We set up our quasi-corporation but our subsidization still goes on.

But break it down to units that can be economically effective and let the government keep the responsibility for where it cannot be converted.

Mr. POOLE. What we intend to explore in our seminar/summit meeting is ways of emulating the British and Argentine experience of franchising out individual routes and trying to explore what the economics of that would be, and what the legal feasibility would be.

As I understand it, there is a potential problem with the current Amtrak law that only Amtrak is now federally authorized to provide passenger service over the rail lines that are owned by the freight railroads. So that means that any other organization would either have to be a part of Amtrak, or in some legal sense tied to Amtrak, or the law would have to be changed to permit that.

Some of the freight railroads are very, very concerned about the addition of other providers because in the days when Amtrak was originally authorized there was a lot of surplus capacity on the freight railroads. Today in many markets there is not much surplus capacity. So it can become a real operational problem.

I wish I could tell you what we are going to conclude, but—this will not, unfortunately, be until after your March 21 session. It is the last weekend in March that we are having this seminar. But we certainly are intending to publish something on this and we will keep your committee informed.

Ms. MOLINARI. I appreciate that. The other thing to keep in mind also is the issue of liability since the freights do assume a significant portion of liability for Amtrak. We would have to, obviously, restructure something for the private passenger rail operator. But we do look forward to that.

I also just ask you to take this with you. Even past March 21, if there are segments of the law that we have failed to address that your group sees as an impediment toward moving closer to privatization than we are able to do currently, alert us to that. Continue to think past that point, acknowledging the fact that we are more than willing to change and reshape the law if we think that it will benefit the continuation of service.

Thank you, gentlemen. Thank you, Mr. Chairman.

Mr. SMITH OF MICHIGAN. Are there any followup questions, Mr. Brownback?

Mr. BASS. No.

Mr. SMITH OF MICHIGAN. Mr. Costello.

Mr. COSTELLO. No.

Mr. SMITH OF MICHIGAN. Gentlemen, thank you very, very much for your time and expertise in this area.

The next meeting of the committee is next Tuesday, March 7, at 10 a.m. The witnesses will be Roger Brenner and Lawrence Meyer on economic forecasting. The committee is adjourned.



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[Whereupon, at 11:54 a.m., the committee was adjourned.]







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